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ABSTRACT

This report examines trends in local government revenues, expenditures and debt from 1977-82. During the period, local governments were subject to cuts in federal aid, severe economic recession and restrictions on revenues and spending, necessitating a fiscal response. Spending reductions were common, especially in big cities. Rural governments were characterized more by tax and spending increases. While most urban and rural areas were able to reduce property tax burdens by offsetting increases in non-tax revenues, only big cities were able to reduce significantly the overall fiscal burdens for their residents. Real spending reductions were mostly in education. While student enrollment declined 10% during the period, the number of teachers dropped only 1%. Reduced school construction and lower real teachers' salaries were factors, especially in big cities. In rural areas, local governments rapidly increased their real current spending, apparently to meet higher costs for utilities and health services. Because incomes did not grow as fast as spending, more revenue efforts were required, increasing fiscal stress on taxpayers. Governments in totally rural areas benefited from fiscal capacity growth and increased state aid, allowing them to reduce local government fiscal pressure on taxpayers. Revenue efforts have been rising in rural areas relative to urban areas and revenue efforts in totally rural areas now exceed those of large central cities. If these trends continue, the economic development potential of rural areas may be threatened. (Numerous tables and figures and 28 references are included.) (TES)

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Rural and Urban Government Fiscal Trends, 1977-82

Richard J. Reeder

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ABSTRACT

Striking differences exist between urban and rural trends in revenues, expenditures, and debts of local governments for 1977-82. The biggest difference was the way urban and rural areas reacted to cuts in aid. As real Federal aid declined, big city governments cut real spending and reduced their local revenue raising efforts. Most rural governments increased real spending by increasing their local revenue efforts, resulting in higher fiscal burdens on rural residents.

Keywords: Local government finances, fiscal indicators, fiscal trends, fiscal conditions, fiscal stress.

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SUMMARY

This report examines trends in local government revenues, expenditures, and debt from 1977-82. During this period, local governments were subject to significant cuts in Federal aid, severe economic recession, and restrictions on revenues and spending associated with tax revolt. Real (inflation-adjusted) spending reductions were common, especially in big cities. Rural governments were characterized more by tax and spending increases. Although most urban and rural areas were able to reduce property tax burdens through offsetting increases in nontax revenues, only big cities were able to reduce significantly the overall fiscal burdens imposed on their residents.

Real spending reductions, when they occurred, were mostly in education. Declining school enrollments brought about reduced school construction and lower real teachers' salaries. Big cities appear to have benefited most from such reductions, which freed up money to provide tax relief. Together with substantially increased fiscal capacity, these savings enabled big cities and their suburban fringe metropolitan areas to reduce their tax burdens considerably.

In rural areas, local governments rapidly increased their real current spending, apparently to meet higher costs for water and sewer, public utilities, and health and hospital services. Because fiscal capacity (income) did not grow as rapidly as spending, higher local government revenue efforts (locally raised general revenues as a percentage of income) were required, increasing fiscal stress. This fiscal stress appears to have been greatest in urbanized and less urbanized nonmetropolitan areas, where fiscal capacities grew the least and real current expenditures grew the most. Governments in totally rural areas benefited from substantial growth in fiscal capacity and increased State aid, allowing them to reduce the local government fiscal pressure on their taxpayers.

Although the growth of local government spending may have enhanced the quality of life in many nonmetro areas, revenue efforts have been rising in rural areas relative to urban areas, and revenue efforts in totally rural metro-independent areas now exceed those of large central cities. If these trends continue, the economic development potential of rural areas may be threatened, as some businesses and individuals may choose to remain or relocate in big cities to avoid the rising tax burdens of rural areas. Increased taxpayer resistance to proposed increases in locally financed government services may also be expected. With further reductions in Federal aid and new Federal restrictions on the tax-exempt status of local government debt, rural local government leaders will have to look more to the State government and the private sector for financing services required for future economic development.

Rural and Urban Government Fiscal Trends, 1977-82

Richard J. Reeder

INTRODUCTION

Recent publicity surrounding the farm crisis, the depressed energy and extraction industries, and difficulties associated with the increasingly competitive and unpredictable world economy has led to concerns about the fiscal condition of local and State governments in rural areas (19).[1] Many rural areas whose populations stabilized during the seventies are once again facing the problem of population loss and its attendant fiscal challenges for local government. These challenges exist even in rural places without declining economies and populations. For example, rural areas with growing elderly populations--such as retirement destination places--may be under significant fiscal pressure because of increased demands for health-related services. Although local governments have managed to handle similar problems in the past, the recent termination of General Revenue Sharing (GRS) and the reduction of other Federal aid programs raises questions about their ability to meet these fiscal challenges (19).

In our system of government, local governments are expected to play key roles during economic difficulties, both in maintaining essential public services and in initiating transition strategies for renewed economic development. But in the current situation, some rural local governments may have to reduce spending on essential public services and infrastructure, and long-term economic development may suffer. The alternative to reducing spending is to raise local taxes. Raising taxes, however, may create economic problems for local governments in the future and set back development efforts.

Current data are very limited for analyzing these developments. Some recent surveys suggest that many local governments have chosen to cut spending or raise taxes.[2] Surveys of local government officials indicated that raising taxes seems to be the preferred approach, especially in urban cities and counties. Rural communities, facing slow growth or declines in tax bases, have been less successful than urban communities in increasing local government revenues. Many rural governments may be forced to cut spending or use up their reserve funds.

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[1]Underscored numbers in parentheses refer to items cited in the References.

[2]Two recent surveys deal with this topic: one for city governments in FY1987 (12) and the other for county governments (5).

Those surveys do not provide the detail or comprehensiveness required to identify the sources of local fiscal difficulties or the places most affected. The 1987 Census of Governments will provide the data required for such an analysis, but it will be several years before these data are available. This report provides insights into these questions by examining fiscal trends of the late seventies and early eighties (1977-82), when local governments faced similar economic, demographic, and Federal aid setbacks whose full impact is still being felt today.

During 1977-82, economic growth slowed considerably, ending with a combination of high inflation and economic recession by 1982. The celebrated rural revival of the late sixties and early seventies that produced balanced rates of population growth across most metropolitan (metro) and nonmetropolitan (nonmetro) areas began to falter during 1977-82, as population in many rural areas began to decline (1, pp. 1-8). Meanwhile, a major change was taking place in the Federal Government where, for the first time in many years, Federal aid declined. Coming at a time of significant opposition to higher State and local taxes, the decline in Federal aid forced State and local government officials to make difficult fiscal decisions concerning the level of taxes and public services. The result of these policy decisions was a great concern, as many observers feared that a widespread decline in spending for local public services and in infrastructure would prove to be a long-term impediment to continued economic development.

Using a set of fiscal indicators developed in an earlier report that examined fiscal trends in the midseventies (13), this report identifies significant fiscal trends for these same indicators during 1977-82. Trends in local government expenditures, revenues, and debt reveal important differences in the fiscal challenges facing different types of urban and rural areas and the ways urban and rural policymakers responded to them.

How Rural Local Governments Weathered the First Round of Fiscal Decentralization and the 1981-82 Recession

Federal and State aid (including Federal monies passed through the States) to local governments declined significantly as a portion of local budgets during 1977-82. This decline stemmed partly from reductions in Federal assistance but also from significant increases in revenues raised by local governments, especially through nontax sources such as user fees and interest receipts. Rural areas, however, were less able or willing to reduce property taxes, and they continued to rely more on property taxes than did urban governments.

The fiscal capacity of most rural and urban governments grew during 1977-82, allowing many governments to expand total services or provide tax relief. Some governments increased revenue efforts to finance growth in services, while others sacrificed some services to reduce revenue efforts, but few were forced to both increase their revenue efforts and reduce their overall level of services. This is surprisingly good news because the last year covered was in the trough of a serious recession and there had been speculation that many local governments would lose ground on both fronts (18, p. 172).

Rural local governments responded to the first wave of fiscal decentralization much differently than large core cities. Rural governments increased taxes and fees, thus taking a bigger share of the personal income of their residents than they previously had. They did this to increase or maintain services--especially health and utilities--and capital expenditures. Big cities actually reduced spending, especially capital spending and spending on education, and reduced

taxes and fees. By 1982, local governments in the most isolated rural places took a bigger fraction of personal income than anywhere else (7.5 percent), with large core cities second (6.9 percent) and small- and medium-sized metropolitan governments taking the least (5.6 and 5.4 percent, respectively).

There are important differences among rural areas on the basis of their degree of urbanization and proximity to metropolitan areas, and their region of the country. With the exception of large core metro areas, revenue efforts (the percentage of local income raised in the form of taxes and user fees) are lower for places with greater degrees of urbanization. Places adjacent to metropolitan areas have lower revenue efforts than nonadjacent places. Revenue efforts are highest in the West and lowest in the South.

Trends in revenue effort also vary by place and region. An important reason for increasing revenue and tax efforts in some areas was the slower pace at which personal income and, hence, local tax bases grew. Urbanized nonmetro areas, especially those in the North Central Region, had relatively little growth in per capita income, and this is reflected in their substantial increase in revenue effort. Large metro areas (core and fringe), especially those in the Northeast and the West, benefited from large income growth, which helped to reduce their revenue efforts.

Spending on education and welfare shrank (after adjusting for inflation), while spending on health and utilities grew. This occurred in all areas, although education and welfare spending cuts were larger for metro areas and health and utility spending increases were larger for nonmetro areas.

A positive note for all categories of local government was the reduction of real outstanding long-term debt, which is backed by the communities. This reduction was largely the result of inflation. It is also evidence of declining investment in physical infrastructure that may have growing annual costs in the future. Real capital spending declined notably for most metro areas and for many nonmetro areas. Capital spending increased significantly only in isolated, totally rural areas.

The pattern described in this study has implications for rural areas:

- Because fiscal capacity grew in all categories of local governments, despite the serious recession, there is reason to temper some of the earlier pessimism about the resilience of rural communities and their governments. Because the recovery has not been as kind to rural as urban areas, undue optimism is probably not warranted.

- A competitive level of public spending is critical. Areas that are struggling to survive and grow must remain competitive in the services they provide; otherwise, they will lose population. As industrial location studies have shown, public education and other local services and amenities are important factors in attracting business investment. Rural local governments are trying to remain competitive.

- Reasonable tax rates are also an important factor in a community's attractiveness to residents and newcomers. The comparative advantage of small rural communities in terms of local taxes has eroded to the point that many rural areas are now at a disadvantage compared with neighboring urban areas.

- Increasing reliance on fees rather than taxes probably shifts more of the costs of local services to lower income people. This, together with rising revenue efforts, may make it more difficult to obtain widespread support for increasing or maintaining services in some rural areas.

- Although the decline in education spending may be a product of declining enrollments and a shift away from youth development toward health services associated with the elderly, it suggests community decline and potential future problems for development. Reductions in spending on education in the period examined should not be continued.

- The trends point out another source of pressure for rural areas. Unless there is either significant growth in rural local income or an increase in transfers from other sources (State or Federal governments), some small communities may find themselves in a cycle whereby current economic problems contribute to higher tax burdens or reduced government services, accelerating economic and population declines.

Methods Used in the Analysis

The indicators used in this report are ratios, expressed in per capita or percentage terms. The census of governments, a survey of all local governments taken every 5 years, is the only data source that provides comprehensive fiscal information on rural governments. The latest available census of governments data are for fiscal year 1982. Census data tapes provided figures on revenues, spending, and debt, reflecting all county, municipality, town, township, school district, and special district government finances. These data were aggregated to the county (or Census Bureau-defined county area) level. I computed ratio indicators for each county using these data. Next, I computed unweighted averages (or simple means) of individual county indicators for all counties within each urban and rural category. This approach gives equal weight to each county within a given category, guaranteeing that lightly populated areas receive weights equal to those of more densely populated areas in the same category.[3]

The focus is on fiscal trends, which are reported in parentheses in the tables 2-8. These trends were computed as follows: 1) ratios were computed for each county for FY1977 and FY1982, 2) the absolute change in the ratio from 1977-82 was computed for each county, and 3) an unweighted average of these individual county absolute changes was computed for each urban and rural category. Absolute, rather than percentage, changes are reported because percentage changes for some individual counties may be exceedingly large if the ratio for the initial year is close to zero.

The fiscal indicators used in this report fall into three major categories: expenditures, revenues, and debts. Within each category, different types of indicators are examined, as illustrated by the following breakdown.

Expenditures:
- Direct current expenditures per capita,
- Direct capital expenditures per capita, and
- Total direct expenditures per capita by function.

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[3] Alaska, Hawaii, and the District of Columbia were excluded because of unique demographic and intergovernmental characteristics that tend to produce statistical "outliers" when calculating unweighted averages.

Revenues:

- Intergovernmental aid per capita,
- Intergovernmental aid as a percentage of total revenues,
- Own-source general revenues as a percentage of income,
- Property taxes per capita, and
- Property taxes as a percentage of own-source general revenues.

Debts:

- Outstanding long-term debt per capita by function,
- Outstanding long-term debt per dollar of income, and
- Outstanding long-term debt as a percentage of general revenues.

Data limitations for rural government finances precluded the use of some more commonly used measures of local government fiscal conditions. For example, property value would be a useful measure of fiscal capacity, but the Census Bureau does not provide adequate property data for analyses of nonmetro areas (15, pp. 29-31). Hence, per capita income is used as a measure of fiscal capacity.

To examine variations among urban and rural areas, four metro and six nonmetro categories were used (table 1). Nonmetro categories differ by concentration of population (urbanized, less urbanized, or totally rural) and by their relationship to nearby metro areas (dependent or independent).

The distinction between dependent and independent nonmetro areas is important because residents of nonmetro counties adjacent to metro areas often commute to metro areas to work, to shop, or to enjoy urban amenities (such as airports, theaters, museums, libraries, and sports). In dependent areas, rural residents may come to depend on metro-provided public services to such an extent that it noticeably increases the public service demand in the metro area, while reducing the public service demand in the rural residents' own communities. As a result, tax and spending levels in such metro-dependent areas tend to be lower than in nonmetro areas with no nearby metropolitan area.

With this concept of metro-dependency in mind, this analysis defines dependent nonmetro counties as those that are both contiguous with a metro area and have 2 percent or more of their labor force commuting to a metropolitan central county area for employment. Independent nonmetro areas are more self-sufficient and, hence, exhibit different fiscal characteristics. Their economic and demographic situations are also independent and distinct from those of metro or metro-adjacent areas--another reason for making this distinction.

Metro categories differ by population size (large, medium, and small). Large metro areas were further divided into core and fringe counties within the metro area. Large core, medium, and small metro areas were considered independent, while fringe metro areas (the suburbs of large cities) were considered dependent. Here again, dependency refers to the extent that residents of one place depend on the public services of another place.

A large portion of residents of fringe metro areas commutes to core counties (counties containing the central cities) for employment and for other purposes. Fringe counties are clearly dependent. An argument could be made that many residents of core counties commute to fringe areas for shopping and recreation, if not for jobs. But the extent of this city-to-suburb commuting pales in comparison with suburb-to-city commuting. Core counties also tend to be self-sufficient in terms of providing the full range of public services. Hence, they are defined here as independent.

Table 1—Metro-nonmetro classifications

Type of area	Definition (based on 1970 population)	County areas 1/
Metro:		Number
Large core	Counties containing the primary central city of a large (over 1 million) MSA 2/	51
Large fringe	Suburban counties within a large (over 1 million) MSA	182
Medium	Counties of a medium-sized (250,000-1 million) MSA	293
Small	Counties of a small-sized (50,000-250,000) MSA 3/	201
Nonmetro:		
Urbanized dependent	Nonmetro counties with 20,000-50,000 urban residents; adjacent to a metro area 4/	147
Urbanized independent	Nonmetro counties with 20,000-50,000 urban residents; independent of a metro area 5/	143
Less urbanized dependent	Nonmetro counties with 2,500-20,000 urban residents; adjacent to a metro area	557
Less urbanized independent	Nonmetro counties with 2,500-20,000 urban residents; independent of a metro area	755
Totally rural dependent	Nonmetro counties with fewer than 2,500 urban residents; adjacent to a metro area	220
Totally rural independent	Nonmetro counties with fewer than 2,500 urban residents; independent of a metro area	552

1/ The number of county areas may differ from other studies because some county areas have been consolidated and Alaska boroughs have been excluded to facilitate comparisons over time; Hawaii and Washington, DC, were also excluded.

2/ In States that do not have county jurisdictions, county areas have been defined by the Bureau of the Census. For the New England States, New England Metropolitan County Areas are used to categorize county areas.

3/ A Metropolitan Statistical Area (MSA) is a county or group of contiguous counties, usually containing one or more cities with a combined population of 50,000 or more, as defined by the Office of Management and Budget, 1983. Nonmetro counties are all counties other than those within MSA's.

4/ Dependent means the county is adjacent to an MSA and has at least 2 percent of its employed labor force commuting to an MSA.

5/ Independent means the county is either nonadjacent to an MSA or it is adjacent but less than 2 percent of its employed labor force commutes to an MSA.

LOCAL GOVERNMENT EXPENDITURES

With the onset of recession and the decline in Federal aid in the early eighties, many officials feared widespread reductions in local government spending, affecting not only current services but also capital infrastructure. However, the per capita expenditure trends examined here show that reduced current spending was found primarily in large metro areas, while reduced capital spending was more common across both urban and rural places. Rural areas, especially those independent of metro areas, were more likely to run into fiscal difficulty from spending increases than from spending cuts, with most of the increases coming from utilities, health and hospital services, and other government functions.

Current and Capital Expenditures

Current expenditures per capita is a rough but commonly used measure of public services. Current expenditures account for the bulk of local government expenditures. Current expenditures refer to spending on current services; it excludes capital construction projects and interest payments. When adjusted for inflation, current expenditures trends from 1977-82 often point to important changes in public service levels, as well as the extent to which local governments may be achieving budget savings through reductions in services.

Only large metro areas (core and fringe) were generally characterized by cuts in current spending (table 2). The average core metro county reduced current spending $23 per capita, a noticeable but not extremely large reduction when compared with its $1,255 current spending level in 1982. The average fringe metro county cut its current spending by only $18 per capita.[4]

In contrast, rural areas and small and medium metro areas increased current spending levels. The largest increases were in independent nonmetro areas, ranging from $50 in totally rural areas to $64 in urbanized nonmetro areas per capita. Dependent rural areas increased their current spending by smaller, but still noticeable amounts ($11 to $30 per capita), while small and medium metro areas also had relatively small increases.

These trends point to an interesting urban-rural dichotomy. Metro areas were characterized by slow spending growth or spending cuts. The more urban the metro category, the more the category was characterized by slow spending growth or spending cuts. Nonmetro areas were characterized by increases in current spending. The increases were largest among independent nonmetro areas where spending increased more in the more urban categories (fig. 1).

Trends in current spending can indicate potential fiscal problems, but more information is required to confirm whether such problems will occur. Either an increase or a decrease in spending can cause difficulty. Spending increases characteristic of rural areas may require raising tax rates or debt levels, which may reduce the attractiveness of the community to prospective businesses or individuals. Spending cuts by larger cities may result in reduced services, which may detract from the cities' competitive positions with respect to other communities. Without knowing more about these developments, it is difficult to say whether these spending changes actually result in fiscal problems.

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[4] From here on, the word "average" will be dropped from the text.

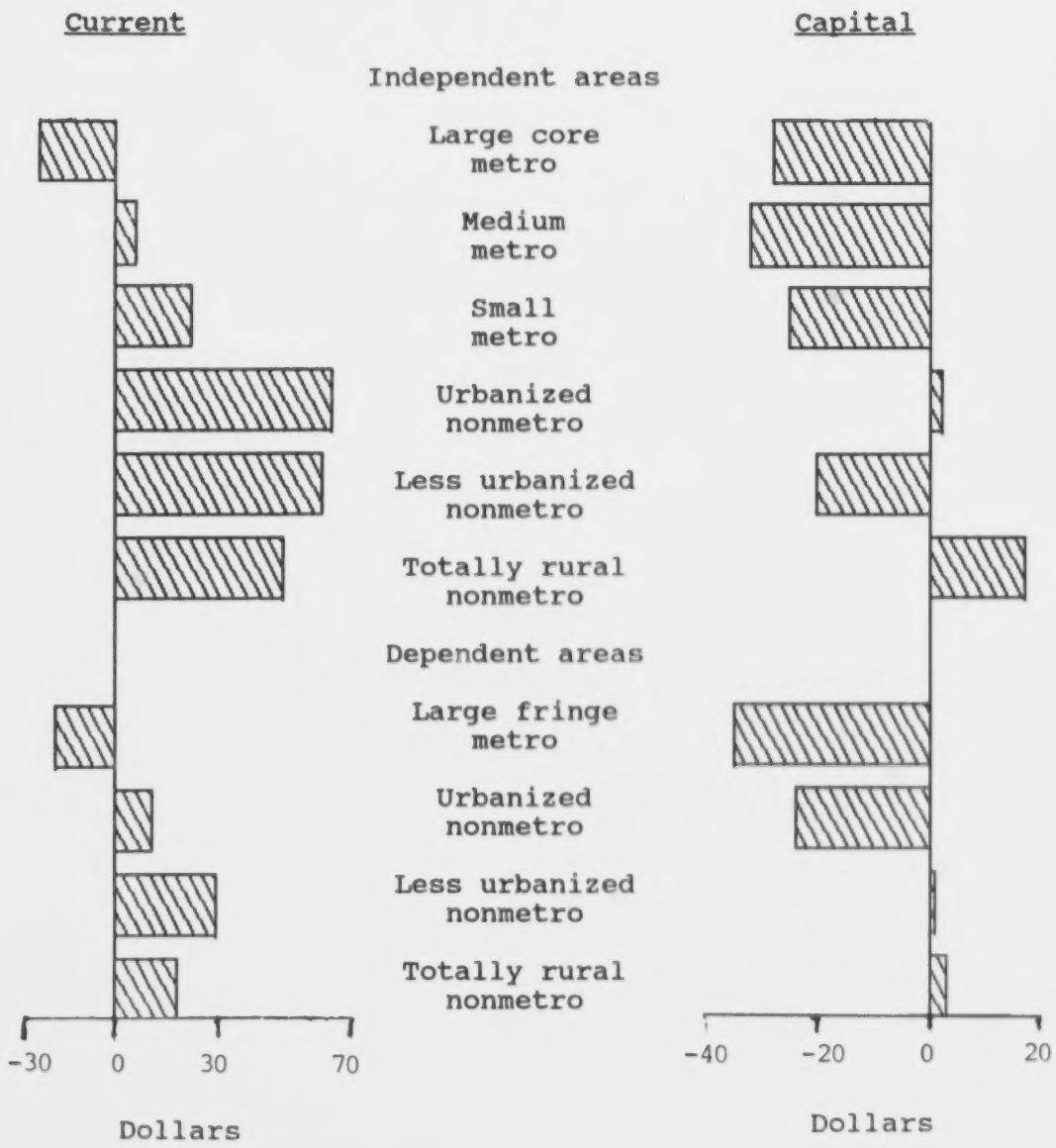
Table 2—Direct expenditures per capita, 1982 1/

Type of area	Total expenditures 2/	Current expenditures	Capital expenditures
		Dollars	
Independent:			
Metro—			
Large core	1,584	1,255	249
	(-42)	(-23)	(-28)
Medium	1,048	866	129
	(-15)	(6)	(-32)
Small	1,156	860	146
	(7)	(22)	(-25)
Nonmetro—			
Urbanized	1,208	967	178
	(80)	(64)	(2)
Less urbanized	1,162	961	153
	(57)	(61)	(-20)
Totally rural	1,177	976	164
	(83)	(50)	(17)
Dependent:			
Metro, large fringe	1,063	877	134
	(-48)	(-18)	(-35)
Nonmetro—			
Urbanized	1,084	898	143
	(-5)	(11)	(-24)
Less urbanized	1,021	846	135
	(43)	(30)	(1)
Totally rural	982	818	125
	(29)	(18)	(3)

1/ 1977-1982 changes in per capita expenditures are in parentheses and are expressed in 1982 constant dollars.

2/ Total includes current, capital, interest, and other expenditures. Intergovernmental payments are excluded from all categories.

Figure 1--Trends in current and capital spending, by area *

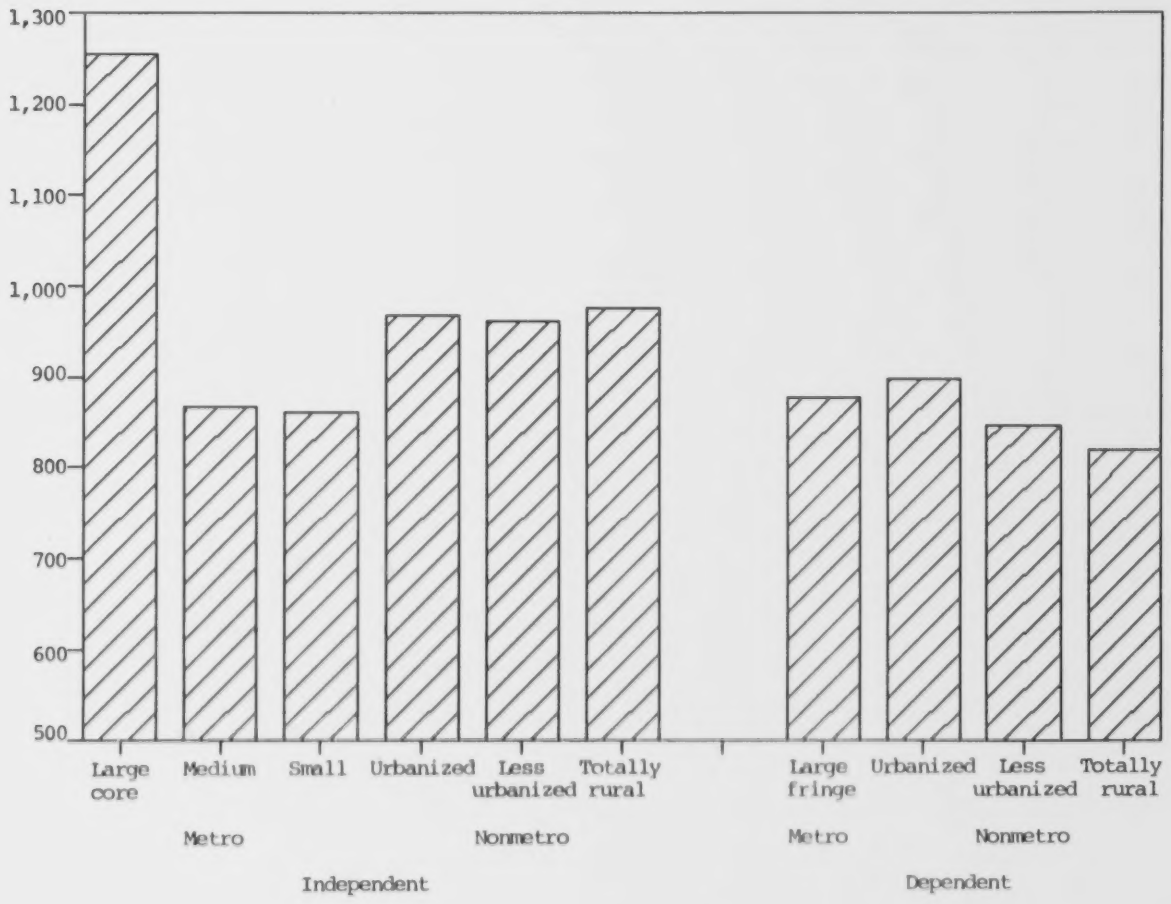


* 1977-82 change in 1982 dollars per capita.

Per capita spending levels for 1982 take on a distinct "U-shaped" curve for independent areas, with higher per capita current spending levels at the urban and rural ends of the spectrum (fig. 2). This U-shaped curve conforms to conventional economic theory, which suggests that there is a city size (or degree of urbanization) at which economies are optimized in the production and distribution of public services (13). If the observed U-shaped curve mainly reflects size economies, then small and medium metro areas--having only $860 per capita current spending--appear to be in the best situation, at least over the long run. Both larger and smaller independent areas face higher costs in providing public services. Core areas face higher per capita costs than medium or small metro areas because of congestion-related costs. Totally rural places face higher costs than less rural nonmetro areas because their populations are small and geographically dispersed, making it more costly to provide public services.

For dependent areas, the inverse of the U-shape is observed. One possible explanation for this phenomenon is that the availability of substitute public goods in nearby central cities is most attractive to highly rural areas (whose costs of directly providing the services is greatest) and fringe metro areas (which are closest to metro areas and also face high congestion costs in direct

Figure 2--Per capita current spending, 1982



provision). Hence, local governments in these dependent areas provide less public services and spend less on current expenditures per capita than dependent urbanized nonmetro areas. For more discussion, see (13, p. 4).

Spending trends were not necessarily mirrored in individual regions (see Appendix). Only in the West was reduced current spending restricted to large and medium metro areas. Reduced current spending characterized most urban-rural categories in the Northeast, was not observed in the South, and no obvious patterns were observed in the North Central Region.

Inferring from trends in current spending requires an understanding of the context in which the trends occur. The decline in metro government spending in the Northeast and the West took place in the context of tax revolt. In these regions, spending cuts probably reflect conscious attempts to reduce relatively high tax burdens on businesses and individuals. Although reduced public services may have resulted from this decision, these changes were enacted with the goal of increasing economic competitiveness. If this strategy proves successful, as it appears to have been in the case of Massachussetts, it may improve economic development rather than discourage it, as is more commonly the case when public services decline.

The finding that current spending increased for most types of urban and rural areas suggests that public services did not suffer as much as some might have expected, given the recession and aid reductions in the early eighties. But a different picture emerges from capital spending trends.

Only totally rural independent areas significantly increased capital spending. Stable or declining capital spending levels elsewhere suggest that many public officials curtailed plans for infrastructure spending, opting instead to maintain or increase current services at the future's expense. The most striking indication of this kind of response to fiscal stress is for metro areas, urbanized dependent nonmetro areas, and less urbanized independent nonmetro areas, all of which decreased capital spending by $20 or more per capita. Most other nonmetro areas showed negligible growth in capital spending, representing a slowdown in the growth in capital spending, compared with that of earlier periods (13, p. 21).

For those who would view spending reductions (both current and capital) as the most pronounced sign of fiscal stress, metro areas--especially large metro areas--appear to be worse off than other places. These trends, however, must be put in perspective. Large metro areas, which sustained the biggest spending cuts, continue to have the highest current and capital spending levels of all urban and rural places. Their spending reductions are relatively small compared with their high levels of spending. Even with large cuts in capital spending, the high level of spending for core metro areas offers no evidence to suggest that any major disinvestment in capital occurred.[5] In fact, declining capital spending in core metro areas appears to be related to reduced need for capital construction of schools, rather than any major reduction in highways and other brick and mortar infrastructure vital for economic development.

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[5] The Census definition of capital spending does not include ordinary maintenance of infrastructure. Even in the face of substantial capital spending, it is possible that cutbacks in the maintenance occurred, resulting in depreciation of the infrastructure. This behavior has occurred in some of the large cities studied during this period, and it is not detectable from census data.

These trends suggest that rural local governments may have been under considerable pressure to increase tax rates to finance rapidly growing spending at a time of reduced Federal aid. Without a parallel increase in local tax bases, rural governments must impose higher tax rates to pay for the additional public services, something that most governments try to avoid. Voter approval of higher tax rates is easier to obtain for improvements in popular public services, such as education and highways. But spending did not increase for these functions.

Both urban and rural governments made large reductions in education spending and large increases in utility spending, after adjusting for inflation (fig. 3). Reductions in welfare spending and increases in hospital and health spending were also reported for both urban and rural areas. It is difficult to say whether these "real" increases or decreases reflect changes in service levels or reflect changes in costs not detected by the inflation adjustment used in this study.[6] The latter may be the case for education, whose costs have declined due to falling school enrollment, and for utilities and health and hospitals, whose costs have increased substantially due to rapidly rising medical and energy costs. Extraordinary changes in costs would not explain the decline in welfare spending, however.

While the costs of most local government goods and services increased considerably during 1977-82, education costs grew more slowly and in some cases may have even declined because of reduced school enrollment and small increases in teachers' salaries.[7] Much of the decline in per capita real education spending may be associated with reduced capital construction of schools in places with declining enrollment and, hence, does not necessarily reflect declining service levels.[8]

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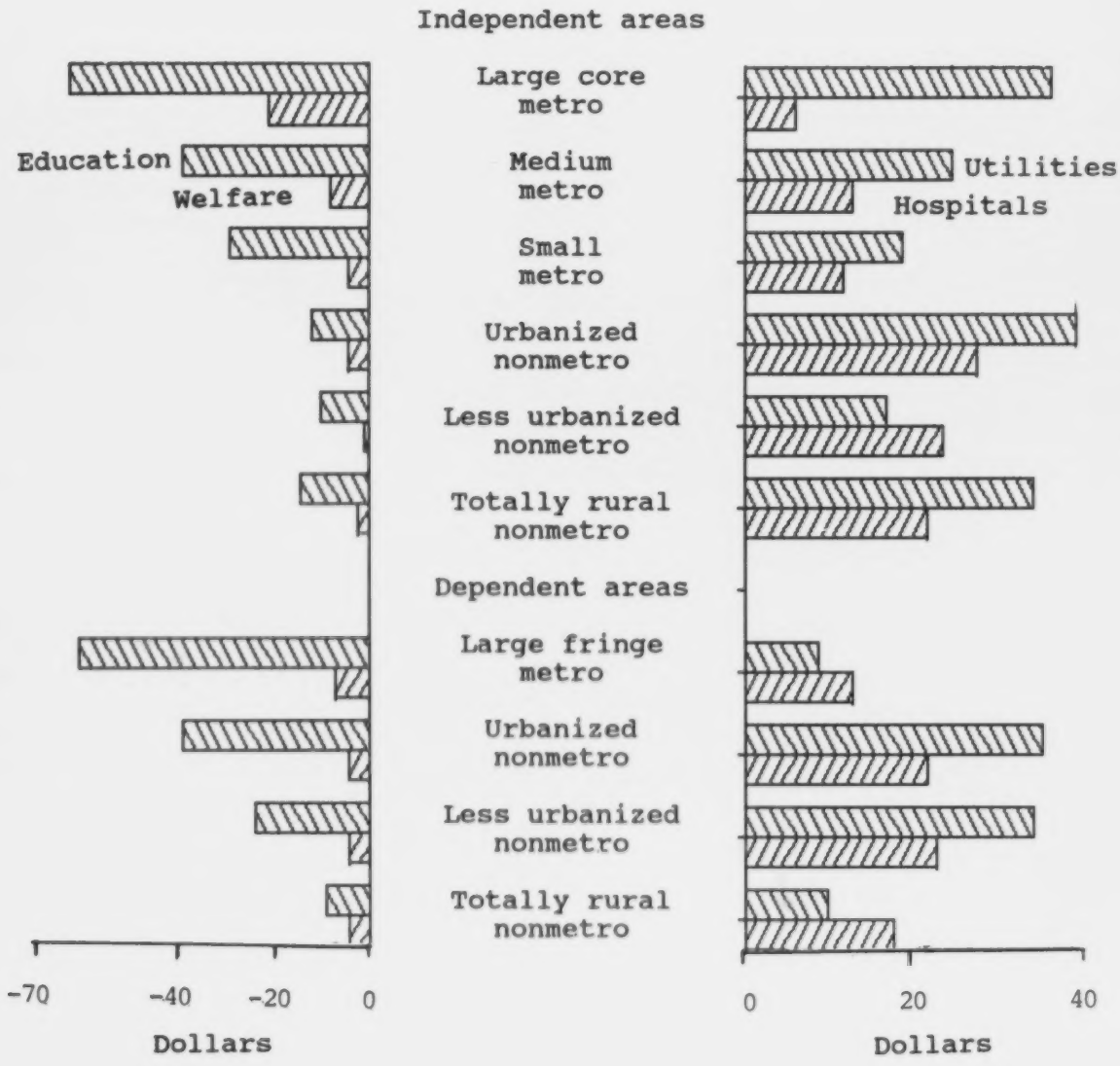
[6] Different rates of change in costs for different functions were not figured into the spending trends reported because no estimates were available for the costs of individual functions (table 3). Instead of using different deflators for different functions, a single deflator (the implicit price deflator for all State and local purchases of goods and services) was used to adjust trends in each of the individual functions. These estimates of inflation-adjusted trends are not good indicators for trends in real service levels for functions whose costs rose more or less than the average.

[7] According to data provided by State departments of education, total fall enrollment declined 10 percent from 1977-82, but the number of classroom teachers declined only 1 percent. There was actually an increase in the teacher-student ratio nationwide. Slow growth in teachers' salaries appears to be a more important factor in the slow growth in education spending. Average teachers' salaries increased only 44 percent from 1977-82, which is less than the 50-percent increase incurred by government goods and services in general (10).

[8] Current spending per pupil increased 73 percent in nominal dollars (not adjusted for inflation) from 1977-82, while total capital outlay for education increased only 18 percent (also in nominal dollars and not adjusted for inflation). This suggests that current service levels in education may have actually increased, and the decline in real education spending reflects reduced construction of schools (10, p. 26).

Figure 3--Trends in spending by selected functions, by area *



* 1977-82 change in 1982 dollars per capita.

Reductions in real education spending may have enabled local governments to divert funds to other functions or to reduce tax burdens. Because education spending reductions were larger for big cities and smaller for more rural areas, such spending reductions provided more fiscal relief to urban than to rural taxpayers. For example, large metro areas (core and fringe) reduced their education spending by over $60 per capita, while totally rural areas (independent and dependent), whose 1982 per capita spending levels on education were higher than those of large metro areas, reduced their education spending by less than $15 per capita (table 3).

It is interesting to note that the decline in education spending parallels the capital spending reductions noted in the previous section. The five areas with the largest declines in education spending were the same as the five with the largest declines in capital spending: core, fringe, and medium metro, and urbanized- and less urbanized-dependent nonmetro. This sheds some light on the interpretation of declining capital spending during this period. Much of the decline in capital spending during this period may very well reflect reduced demands for school construction. Capital spending cuts in sewers and highways were not as severe.[9]

Widespread cuts in highway spending suggest that this basic infrastructure may have eroded to some extent. All areas but core metro and totally rural independent areas cut highway spending. Highway and welfare spending cuts were small compared with reductions in education spending. In percentage terms, highway and welfare cuts are still significant, and, unlike education, they may have resulted in noticeable cuts in services.[10]

All urban and rural areas cut welfare spending. The largest cut was in core metro areas ($21 per capita), followed by declines in medium and fringe metro areas of $8 and $7, respectively. Although rural areas reduced welfare spending less than urban areas, rural areas continue to have somewhat lower welfare spending levels.

Most urban and rural areas increased spending on sewerage and sanitation and health and hospitals. The largest increases were in nonmetro areas. Rising sewerage and sanitation spending reflects improved services in both urban and rural areas (16, p. 9). The more rapid increase in rural areas may be associated with diseconomies of scale for small communities that must meet EPA standards designed for larger communities when constructing facilities with EPA funds. Hence, the real decline in Federal aid for sewerage and sanitation projects may be particularly burdensome on local tax bases in rural areas,

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[9] The National Income and Product Accounts data on purchases of governments structures and new construction tend to support this hypothesis. From 1977 to 1982 (calendar years), total government construction spending declined 11 percent in constant dollars, for educational structures the decline was 30 percent (-$2.5 billion in 1982 constant dollars). Sewer and water system construction declined 20 percent (-$2.1 billion), and highway and street construction declined only 7 percent (-$0.9 billion) (27).

[10] The 1982 Surface Transportation Assistance Act reversed this decline in highway aid, but this reversal occurred after the period studied.

Table 3—Direct expenditures per capita by function and area, 1982 1/

Type of area	Education	Police	Fire	Highways 2/	Welfare 2/	Health and hospitals 2/	Sewage and sanitation 2/	Utilities	Other
					Dollars				
Independent:									
Metro—									
Large core	475	81	44	91	82	117	86	252	298
	(-63)	(-3)	(-2)	(5)	(-21)	(6)	(2)	(37)	(-6)
Medium	442	41	21	61	38	74	47	127	154
	(-39)	(1)	(0)	(-1)	(-8)	(13)	(-7)	(25)	(-8)
Small	441	43	23	64	27	87	49	128	155
	(-29)	(2)	(1)	(-6)	(-4)	(12)	(3)	(19)	(.6)
Nonmetro—									
Urbanized	474	42	23	78	21	123	54	191	162
	(-12)	(3)	(3)	(-.5)	(-4)	(28)	(11)	(40)	(2)
Less urbanized	492	37	11	102	20	127	34	151	149
	(-10)	(3)	(.5)	(-3)	(-.8)	(24)	(7)	(17)	(9)
Totally rural	538	34	8	151	20	94	23	91	185
	(-14)	(3)	(.8)	(7)	(-2)	(22)	(12)	(35)	(12)
Dependent:									
Metro, large fringe	489	48	21	62	33	71	49	85	159
	(-61)	(1)	(2)	(-.9)	(-7)	(13)	(-5)	(9)	(-4)
Nonmetro—									
Urbanized	449	40	21	69	37	93	50	141	151
	(-39)	(.9)	(-1)	(-5)	(-4)	(22)	(-19)	(36)	(-.6)
Less urbanized	461	32	10	83	23	98	34	119	127
	(-24)	(2)	(.3)	(-5)	(-4)	(23)	(7)	(35)	(-.1)
Totally rural	503	31	7	99	19	71	20	56	137
	(-9)	(2)	(.2)	(-1)	(-4)	(18)	(10)	(10)	(-5)

1/ Excludes intergovernmental payments, and 1977-82 changes in per capita expenditures are in parentheses and are expressed in 1982 constant dollars.

2/ Census survey categories differed among size and type of government.

especially considering their lower tax bases and higher costs of borrowing (7, pp. 62-63).[11]

Much of the growth in health and hospital spending may reflect extraordinarily large increases in medical costs. The greater nonmetro spending growth for health and hospitals may reflect growing health needs related to the net migration of the elderly from metro to nonmetro areas in recent years (4).[12]

LOCAL GOVERNMENT REVENUES

Examining local government revenues offers insights into why some places increased spending while others did not, and what the implications of these actions were for the government's fiscal situation and for the community in general. Communities with growing tax bases can often finance rising government expenditures without having to increase tax rates. Slow growing or declining tax bases, on the other hand, make it difficult for local governments to increase spending without raising tax rates and irking local taxpayers. Changes in Federal and State aid also affect the ability of localities to raise spending levels without increasing tax rates. The fiscal situation may be aggravated in some localities when State statutory or constitutional provisions restrict local governments from raising revenues, causing them to rely too much on one or more specific taxes or user charges.

Fiscal Capacity and Effort

Fiscal capacity is the ability of a government to raise revenues. In this study, per capita income is used as the indicator of fiscal capacity.[13] It is presumed that 5-year changes in per capita income will be roughly correlated

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[11] EPA wastewater construction grants were $3.5 billion in 1977 and $3.7 billion in 1982; after adjusting for inflation, this amounts to a substantial decline in purchasing power for Federal aid (28).

[12] Although totally rural areas appear to have increased their health and hospital spending less than more urbanized nonmetro areas, such comparisons may be misleading because small towns and townships report separate spending totals for education, police, fire, highways, and welfare, while their spending for all other functions is reported in an "all other" category. Hence, spending totals for individual functions in this "all other" category are not as reliable for totally rural areas--which contain no municipality with more than 2,500 population--as they are for other urban and rural categories. For more information on the limitations of census data for making urban and rural comparisons, see Collins and Perkinson (2).

[13] For States and metro areas, available data allow for more sophisticated indicators of fiscal capacity, such as those developed by the U.S. Advisory Commission on Intergovernmental Relations (24). These sophisticated capacity indicators more closely approximate measures of actual tax bases. They include property wealth, as well as income, and account for the ability of governments to shift tax burdens to taxpayers in other jurisdictions. Such measures cannot be used here because they require data that are unavailable for most small nonmetropolitan governments. For example, there is no nationally uniform data source for the market value of local property in small communities (23, p. 67).

with changes in local tax bases, although there may be some time lags between the two.[14]

Fiscal effort refers to the degree to which a government actually draws on its tax bases. There are two dimensions to fiscal effort: how high it is and whether it is rising or falling. Governments with relatively high or rising fiscal efforts are vulnerable to a variety of fiscal problems. In such places, there is a greater probability of tax revolt in the form of proposals to roll back taxes or resistance to future tax increases. Governments with high or rising fiscal efforts may also run into constitutional or statutory tax limits that effectively prevent them from raising taxes further.

Governments that manage to increase fiscal efforts despite these political and legal constraints risk falling into a continuing cycle of fiscal difficulites. Facing high and rising taxes, local businesses and individuals may leave for jurisdictions with lower tax rates. Any attempt to maintain services with a declining tax base requires raising tax rates, which may drive additional taxpayers out of the jurisdiction. This cycle could continue until taxpayers resist further tax rate increases and services are cut:

In this study, two fiscal effort indicators are employed: tax effort and revenue effort. Tax effort is the percentage of local resident personal income taken in the form of local government taxes. Revenue effort is the percentage of income taken in the form of all local government-own source general revenue, which includes both taxes and user charges. Revenue effort is the more comprehensive of the two. Because it includes both taxes and user charges (an increasingly important revenue source for financing general government activities), revenue effort will receive the most attention here. Tax effort trends are nevertheless quite important to policymakers because of the high profile that tax burdens (especially property taxes) have with the public.

Despite the effects of the recession in 1981-82, all of the urban and rural categories benefited at least slightly from growing fiscal capacity over the 5-year period (1977-82). However, not all areas benefited equally. Fiscal capacity grew the most at the ends of the urban-rural spectrum: large metro and totally rural areas. Capacity grew the least in the middle of the spectrum: small metro, urbanized nonmetro, and less urbanized nonmetro (fig. 4). This tendency for places in the middle of the urban-rural spectrum to benefit the least from growing fiscal capacity is evident for both independent and dependent areas.

Independent totally rural areas gained the most; their real per capita income grew by $627 (table 4). Large metro areas (both core and fringe), which had the largest fiscal capacity in 1982, also benefited from substantial growth in fiscal capacity ($561 and $536, respectively). Next came dependent totally rural areas, whose fiscal capacity rose by $407.

To some extent, fiscal effort trends reflect these changes in fiscal capacity. Large increases in fiscal capacity appear to have acted as fiscal shock absorbers. In totally rural areas, rising fiscal capacity reduced the need to

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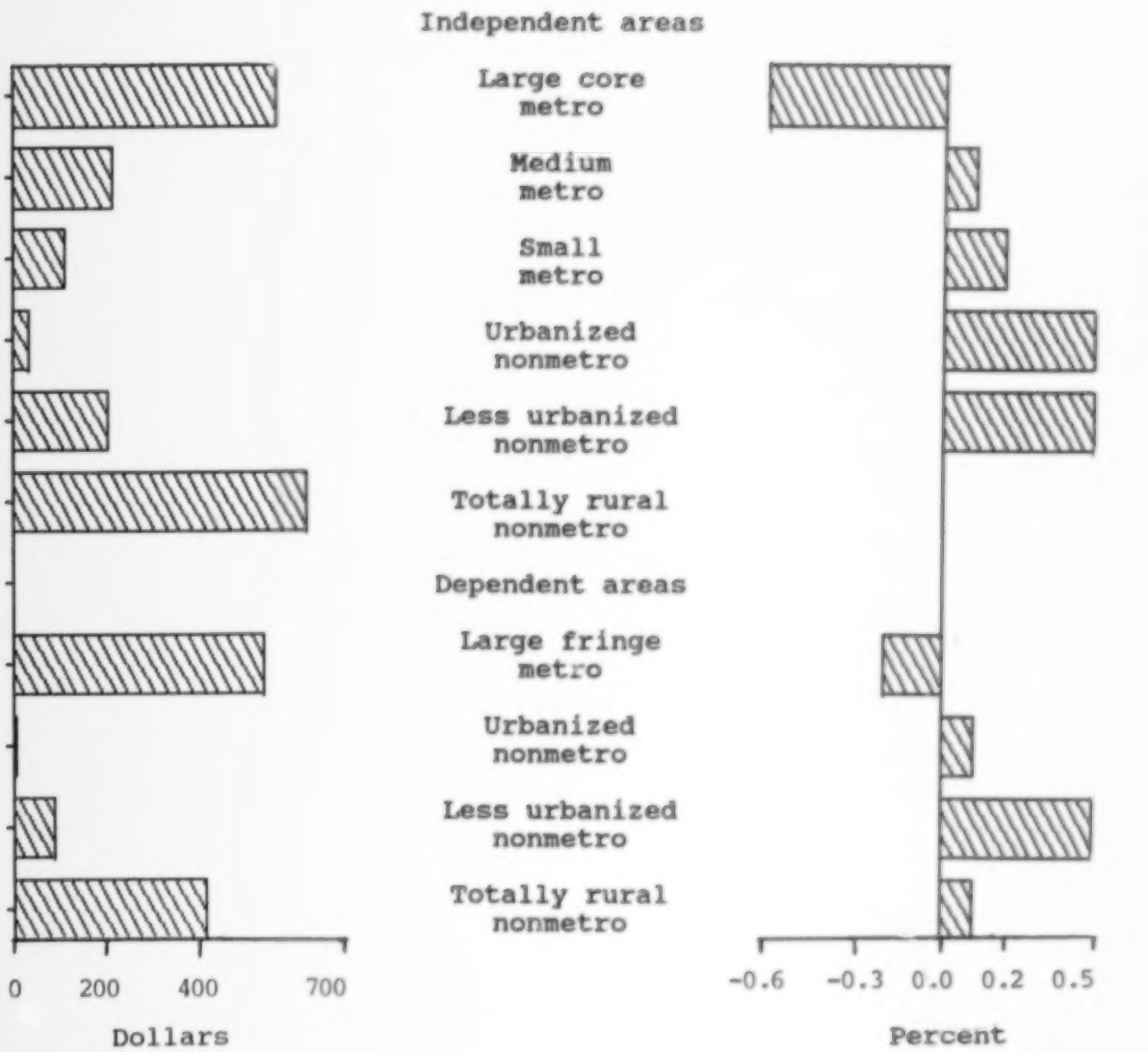
[14] The deflator used to adjust income was the implicit price deflator for purchases of State and local government goods and services. This is used instead of the deflator for personal income or the GNP deflator because changes in government fiscal capacity are most meaningful when measured relative to changes in the price of government goods and services.

Figure 4--Trends in fiscal capacity and revenue effort, by area



1/ Fiscal capacity change is in 1982 dollars per capita.

2/ Revenue effort change is in percentage of resident personal income.

Table 4—Fiscal effort and capacity measures by areas, 1982 1/

Type of area	Fiscal effort		Fiscal capacity 4/
	Tax effort 2/	Own general revenue effort 3/	
	Percent		Dollars
Independent:			
Metro—			
Large core	4.3	6.9	12,174
	(-1.2)	(-.6)	(561)
Medium	3.2	5.4	9,794
	(-.4)	(.1)	(213)
Small	3.1	5.6	9,675
	(-.3)	(.2)	(114)
Nonmetro—			
Urbanized	3.3	6.5	9,279
	(-.3)	(.5)	(34)
Less urbanized	3.7	6.8	8,723
	(-.3)	(.5)	(203)
Totally rural	4.8	7.5	8,619
	(-.7)	5/	(627)
Dependent:			
Metro, large fringe	3.7	5.7	11,283
	(-.7)	(-.2)	(536)
Nonmetro—			
Urbanized	3.3	5.8	9,411
	(-.4)	(.1)	(9)
Less urbanized	3.3	5.9	8,586
	(-.2)	(.5)	(90)
Totally rural	3.9	5.9	8,148
	(-.4)	(.1)	(407)

1/ 1977-82 changes in effort are in parentheses and are expressed as a percentage of resident personal income. Changes in fiscal capacity are in 1982 real per capita dollars.

2/ Local taxes as a percentage of resident personal income.

3/ Local own source general revenues as a percentage of resident personal income.

4/ Resident personal income per capita.

5/ Magnitude of growth or decline less than 0.05 in absolute value.

increase revenue efforts to finance expenditure growth. In large metro areas (core and fringe) where expenditures were cut, rising fiscal capacity allowed local governments to provide considerable tax relief in the form of declining revenue efforts.

The southern and northeastern core metro and western and northeastern fringe metro areas benefited more from growing fiscal capacities and declining revenue efforts than did other metro areas (see appendix). Of these places, only southern core areas increased their revenue efforts. In contrast, metro areas in the North Central region had little or no growth in fiscal capacity, experiencing significant increases in revenue effort. Among nonmetro areas, the largest increase in fiscal capacity occurred for totally rural areas in the West and North Central regions, apparently associated with agriculture and mining and energy developments. In these places, revenue efforts declined substantially. In the same two regions, however, significant decline in fiscal capacity occurred for dependent urbanized and less urbanized nonmetro areas. However, only in the North Central region did this decline in fiscal capacity contribute to significant increases in revenue effort. The largest increases in nonmetro revenue effort were in urbanized areas in the South (where spending increased rapidly) and less urbanized areas in the North Central region.

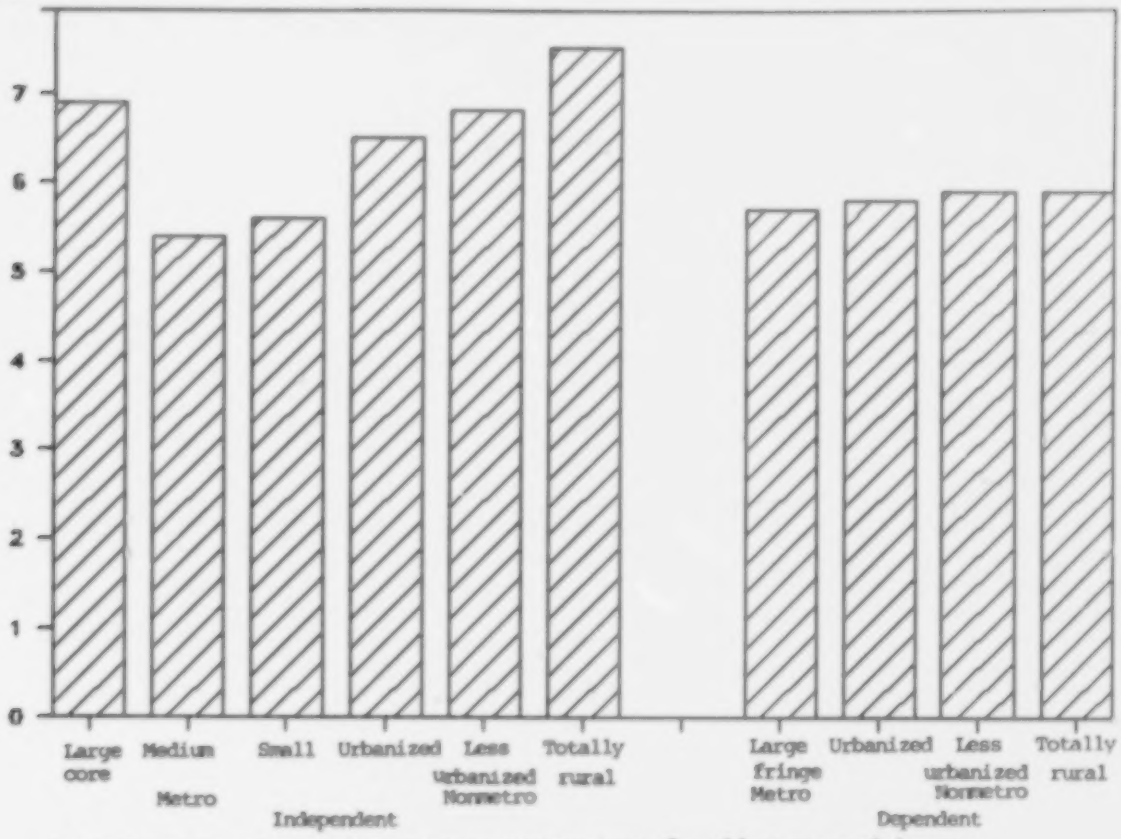
While fiscal trends were generally favorable in larger urban and highly rural areas, they were not so favorable for places in the middle of the urban-rural spectrum. The greatest fiscal stress as indicated by the change in revenue effort was observed for three categories of nonmetro areas: independent less urbanized, independent urbanized, and dependent less urbanized. All three increased their revenue efforts by 0.5 percent of income. They had to increase their revenue efforts to pay for rapidly increasing current spending, while benefiting from little or only modest increases in fiscal capacity. Among metro areas, only small and medium areas increased their revenue efforts, core and fringe declined.

While a fraction of a percentage of income in local revenue effort may seem small, it is probably quite noticeable in the dollar payments of individual taxpayers and firms. To a taxpayer with an income of $20,000, an increase of 0.5 percent in revenue effort is equivalent to $100 in additional taxes and user charges. This is on top of the increase in taxes that results from the inflation increase in tax base. Many taxpayers may not view this as a marginal or negligible increase in tax burden. Consequently, the three nonmetro categories with increases in revenue effort of 0.5 percent of income might encounter opposition to increases in government taxes and spending in succeeding years.

One result of the large decline in revenue effort in core metro areas is that revenue effort is now noticeably lower in core metro areas (6.9 percent of income) than in totally rural independent nonmetro areas (7.5 percent). A U-shaped curve is still observable for revenue effort when charted across the urban-rural spectrum for independent areas (fig. 5). There is little variation among dependent areas with all of them having relatively low revenue efforts (less than 6 percent). If one were to ignore the dynamic, trend aspects of fiscal stress, this static revenue effort indicator suggests that totally rural independent areas have the greatest fiscal stress, followed by core metro and

Figure 5--Revenue effort, 1982 1/

Percent



1/ Local-own source general revenues as a percentage of resident personal income.

other nonmetro independent areas (less urbanized and urbanized), and small and medium metro areas have the least. [15]

Despite the rise in revenue effort in many areas, suggesting increasing fiscal pressure in the majority of metro and nonmetro areas, all categories of urban and rural areas reduced their tax effort from 1977-82. This is testimony to the effectiveness of the tax revolt, beginning with California's proposition 13 and subsequently affecting many State and local governments across the country. The largest decline in tax effort was for core metro areas (-1.2 percent of income), followed by independent totally rural (-.7) and fringe metro (-.7) (see table 4). As noted before, these places benefited the most from growing fiscal capacity, enabling them to provide substantial tax relief. Most other places appear to have financed their relatively smaller amount of tax relief largely with increases in user charges and other nontax revenues.

Intergovernmental Revenues

Some State and local government officials and members of the press have blamed recent State and local government fiscal problems on reductions in Federal aid. Real Federal grants to State and local governments declined only five times

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[15] A map identifying each nonmetro county with high or rising revenue efforts from 1977-82 is presented in (14). This article also provides other fiscal trends computed from census of governments data, aggregated to the national level, metro versus nonmetro.

during 1955-86, but four of these aid reductions occurred in fiscal years covered in this study: 1979, 1980, 1981, and 1982.[16]

Federal aid may be the chief attention getter, but State aid is more important to local government because State aid accounts for a much larger share of total local general revenues. In FY1985, direct Federal aid to local government made up only 7 percent of local general revenues, whereas State aid made up over a third of local general revenue. Total Federal and State aid accounted for 42 percent of local general revenue in FY1985.

Total Federal and State aid to local governments declined in real per capita dollars from 1977-82 for all but one of the urban-rural categories (fig. 6). Intergovernmental aid declined the most for metro areas. Medium metro areas had the largest total aid cut, $45 per capita (table 5). Some nonmetro areas also lost substantial intergovernmental aid, especially the urbanized and less urbanized dependent areas (-$36 and -$21, respectively).

The one category to benefit from Federal and State aid was independent totally rural areas. Despite a substantial $14 per capita decline in the purchasing power of General Revenue Sharing receipts, rural governments in this category lost only $4 per capita in total direct Federal aid, about half the decline recorded for most other nonmetro areas, and an eighth of the decline in core metro areas. Perhaps more important is the fact that this same rural category received a substantial $22 increase in State aid.

It should be noted, however, that wide community-to-community variations in the receipt of Federal and State aid exist within this totally rural category, making it hard to generalize about the impact of these changes in a typical rural community. For example, a 1979 Cornell study of New York villages found:

> that federal aid was intensive rather than extensive and that aggregate figures give a misleading picture of the allocation of federal monies. In any particular year most villages did not get any revenues, but a few got relatively large sums. Moreover, it may be misleading to look at an individual year to assess the magnitude of distribution of federal aid. For example, the Village of Waterville received $520,900 in federal aid in 1970 for public works construction. This represented 59 percent of all its revenues in that year. However, 1970 was the first and only year during the study period that Waterville received any federal monies (9, p. 6).

Two interesting urban-rural patterns are observed in figure 6. First, metro-dependent areas sustained larger cuts in aid than independent places. Second, places in the middle of the urban-rural spectrum sustained larger cuts in aid than places on the ends of the spectrum. These patterns for total aid appear heavily influenced by State aid patterns. State aid declined for five categories of metro and nonmetro areas. Three were dependent areas and two were independent medium and small metro areas. In contrast, State aid increased substantially in only two categories: core metro ($14) and totally rural

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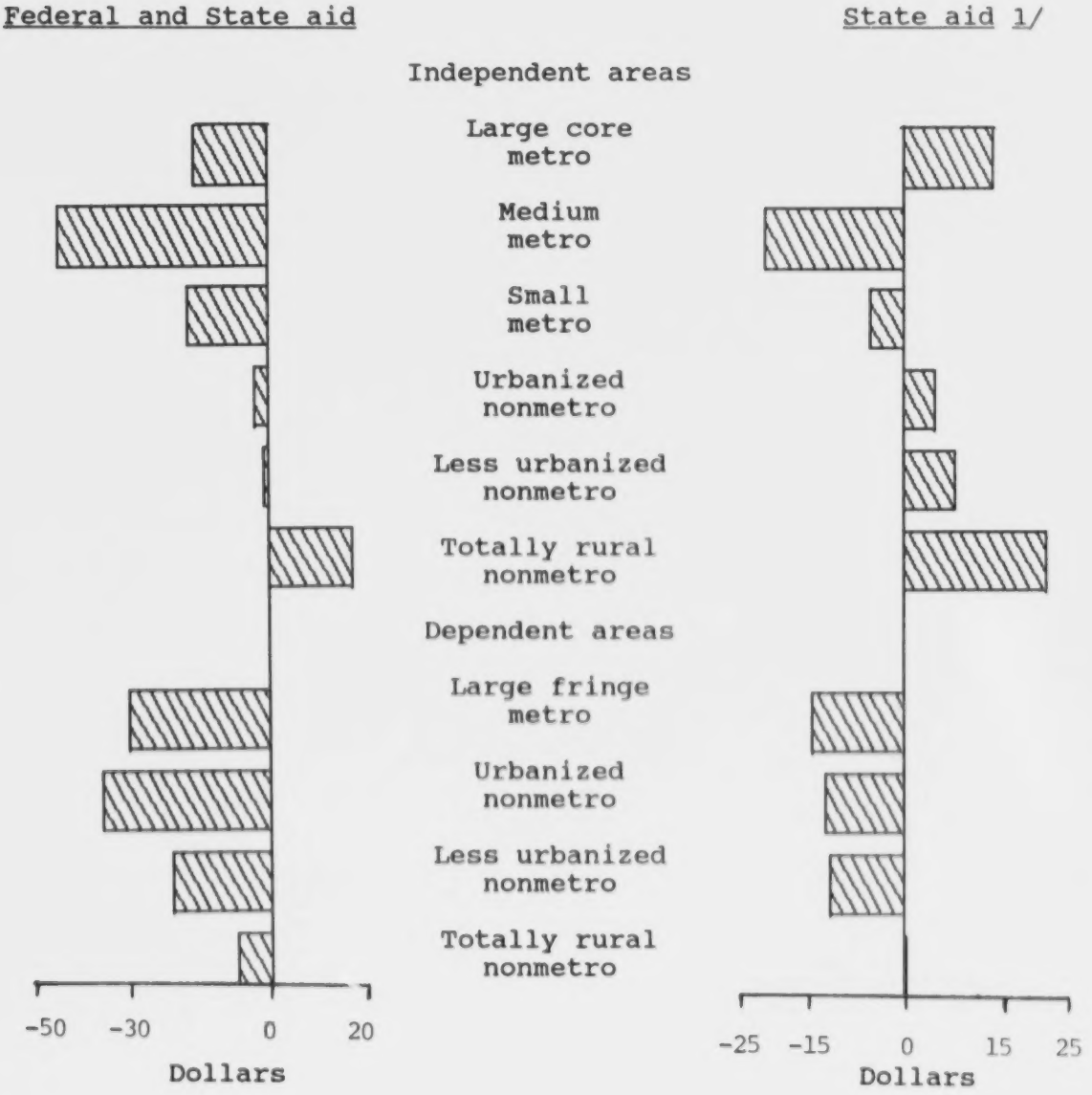
[16] The other fiscal year in which real Federal grants declined was 1974. For the 5 years covered by this study, the year-to-year changes in real Federal grants, in billions of 1982 dollars, are as follows: 1977-78, +6.1; 1978-79, -3.0; 1979-80, -0.8; 1980-81, -5.2; and 1981-82, -12.5. Although real Federal aid subsequently grew about $7 billion from 1982-86, it is estimated that it will decline another $11 billion by FY1988 (25, p. 15).

Figure 6--Trends in total and State aid to local governments, by areas *



* 1977-82 change in 1982 dollars per capita.

1/ Includes Federal pass-through funds.

Table 5—Federal and State aid per capita by area, 1982 1/

Type of area	Federal and State	Federal		State 2/
		Total	General Revenue Sharing	
		Dollars		
Independent:				
Metro—				
Large core	621	143	22	479
	(-16)	(-30)	(-14)	(14)
Medium	405	59	17	346
	(-45)	(-24)	(-9)	(-21)
Small	413	68	17	345
	(-17)	(-12)	(-10)	(-5)
Nonmetro—				
Urbanized	444	76	20	368
	(-3)	(-7)	(-10)	(5)
Less urbanized	437	59	21	379
	(-1)	(-9)	(-11)	(8)
Totally rural	450	61	24	390
	(18)	(-4)	(-14)	(22)
Dependent:				
Metro—				
Large fringe	376	49	15	327
	(-30)	(-16)	(-7)	(-14)
Nonmetro—				
Urbanized	420	58	18	363
	(-36)	(-24)	(-11)	(-12)
Less urbanized	416	51	19	366
	(-21)	(-10)	(-10)	(-11)
Totally rural	440	48	20	392
	(-7)	(-7)	(-11)	(.3)

1/ 1977-82 changes in per capita aid are in parentheses and are expressed in 1982 constant dollars.

2/ Includes Federal funds that pass through State governments.

independent ($22). Both are independent and on the ends of the urban-rural spectrum.

Similar patterns are observed among nonmetro areas for trends in direct Federal aid, but they are reversed in metro areas, where core metro areas suffered a greater reduction in direct Federal aid than either fringe metro areas or medium and small metro areas. Even so, core metro areas still receive over twice as much direct Federal aid per capita as any other metro or nonmetro type of area. All categories received reduced direct Federal aid, but the reductions were quite small in rural areas ($10 per capita or less) with the exception of dependent urbanized nonmetro areas.

Most of the direct Federal aid loss in nonmetro areas was associated with the decline in the purchasing power of General Revenue Sharing receipts. Direct Federal aid other than revenue sharing actually increased slightly in four of the six nonmetro categories. However, the increases were slight.

There are several possible explanations for these urban-rural patterns in Federal and State aid. One explanation views urban-rural differences in aid trends as resulting from trends in local fiscal capacity. Many types of State and Federal aid favor areas with higher fiscal capacities. For example, many State revenue-sharing programs merely return State tax collections to the locality where the revenues originate, so that places with stronger tax bases get more State aid. Stronger fiscal capacity also enhances a government's ability to compete in applying for Federal and State grants. Rapid growth in fiscal capacity might explain why governments at the ends of the urban-rural spectrum experienced increases or only small decreases in Federal and State aid. Rapid increase in fiscal capacity might also explain independent areas' more favorable aid trends compared with those of dependent areas.

Another possible explanation is that some State governments may have deliberately redistributed aid allocations to produce these patterns. Greater equalization in aid to schools--which makes up the bulk of State aid to local governments--could have increased the amount of aid going to the high-poverty school districts, many of which are located in central city ghettos or in isolated rural areas.[17] Some States may have also increased other forms of aid to core metro and totally rural independent areas in response to perceived fiscal difficulty in these areas. Core metro areas had the highest local government revenue efforts during the seventies, with cities like New York and Cleveland experiencing severe fiscal crises. Independent highly rural areas had both high and rising revenue efforts during the midseventies, reflecting substantial fiscal pressure. Some States have enacted programs to address these problems.

The relatively large decline in Federal aid to core counties is probably related to the phasing down of the seventies' economic stimulus programs, such as Local Public Works, Temporary Employment Assistance, and Anti-Recession Fiscal Assistance. These programs tended to favor core counties because of their high unemployment rates. The conversion from direct, Federal-to-local, categorical grants to block grants to the States in the early eighties also probably resulted in a larger reduction in direct Federal aid for core counties than for

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[17] Among metro areas, core counties have the highest poverty rates and have substantially lower median family income than fringe counties. Among nonmetro areas, poverty rates are inversely related to degree of urbanization and are higher in independent areas than in dependent areas (8, pp. 62-64).

less urban areas. If the new State-administered block grants were funded with roughly the same urban-rural pattern as the old categorical Federal programs, then this could account for much of the increase in State aid for core areas.

Regardless of the cause of these aid trends, the effects tend to reinforce the more important effects of changes in fiscal capacities. For example, without the $17 per capita increase in total aid, totally rural independent areas might have had to pare down spending increases or reduce the tax relief provided to local taxpayers. This probably would not have altered the overall pattern, but it would show areas still benefiting from expenditure growth, while showing little increase in revenue effort.

For most urban and rural areas, the decline in direct Federal aid and total Federal and State aid probably forced them to raise more revenues locally, resulting in fiscal stress, reduced spending, or both in some places. Without further analysis, it is difficult to say how significant a factor intergovernmental aid was in this process although it would appear to be of secondary importance relative to the change in local government fiscal capacities.

These trends also caused local governments to reduce their dependency on intergovernmental aid by 1982. Although local governments still obtain over a third of their revenues from Federal and State sources, all of the urban and rural categories reduced their reliance on direct Federal and total aid from 1977-82 (table 6). This may be viewed as a fiscal plus, resulting in greater local control over government revenues and less uncertainty in budgeting for the future.

The reduction in direct Federal aid dependency was a slow process, resulting mostly from the decline in the purchasing power of GRS. Most areas relied on direct Federal aid for 6-8 percent of their general revenues in 1977. The amount was reduced to the 4.5-6.5 percent range by 1982, with only core metro areas still getting more than 7 percent of their revenues directly from the Federal Government. This may have turned out to be a blessing in disguise, because it reduced the fiscal shock associated with the recent termination of GRS. As of 1982, local governments obtained only about 1.5 percent of their total revenues from GRS. However, this figure understates the fiscal effect of the termination of GRS for some heavily affected governments. Only general purpose governments were eligible for the program. Their dependency on GRS was 2.4 percent; 2.5 percent for counties, 2.2 percent for municipalities, and 3.6 percent for townships.[18]

The consolidation of many categorical grants into block grants (at reduced funding levels) has further reduced local government reliance on direct Federal aid. Although this might be expected to boost local government reliance on aid received from State governments, all but core metro areas reduced their reliance on State aid. Despite receiving the largest increase in per capita State aid, independent totally rural areas still reduced their reliance on State aid. This

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[18] Sokolow observes that midwestern townships and local governments in Arkansas, Delaware, Idaho, Kentucky, Mississippi, New Mexico, and West Virginia relied more on GRS than other governments. More profound variations exist from community to community because of variations in fiscal health. "Governments serving small communities and experiencing extended economic distress--midwestern agricultural and northwestern lumber communities, for example--are especially dependent on GRS revenues to fund basic services" (17, p. 12).

Table 6—Aid dependency by area, 1982 1/

Type of area	Federal and State	Federal		State 2/
		Total	General Revenue Sharing	
		Percent		
Independent:				
Metro—				
Large core	38	8.6	1.4	29
	(-.3)	(-1.8)	(-.9)	(1.5)
Medium	40	5.7	1.7	35
	(-3)	(-1.9)	(-1.0)	(-1.6)
Small	40	6.5	1.8	34
	(-3)	(-1.4)	(-1.1)	(-1.2)
Nonmetro—				
Urbanized	38	6.5	1.8	32
	(-3)	(-1.1)	(-1.0)	(-1.6)
Less urbanized	40	5.3	1.9	35
	(-3)	(-1.3)	(-1.2)	(-1.5)
Totally rural	43	5.5	2.3	37
	(-1)	(-.7)	(-1.4)	(-.1)
Dependent:				
Metro, large fringe	35	4.6	1.5	31
	(-2)	(-1.4)	(-.7)	(-1.0)
Nonmetro—				
Urbanized	40	5.6	1.8	34
	(-2)	(-1.9)	(-1.0)	(-.5)
Less urbanized	42	5.0	1.9	37
	(-4)	(-1.4)	(-1.2)	(-2.4)
Totally rural	48	5.0	2.3	43
	(-2)	(-1.3)	(-1.4)	(-.7)

1/ Aid as a percentage of total local revenues, net of interlocal revenues. 1977-82 changes are in parentheses.

2/ Includes Federal funds that pass through State governments.

was achieved by substantially increasing their own source revenues. Nevertheless, local governments remain heavily dependent on State aid, especially totally rural dependent nonmetro areas, which obtain 43 percent of their revenues from the States.

Conclusions from these trends must be drawn with care because of changes in the intergovernmental aid system during the study period. Numerous categorical (direct Federal-to-local) aid programs were consolidated into block grants to States in 1981 and 1982. As a result, some Federal assistance that was previously transferred directly to local government now comes to them via the State government. Simple trends in direct Federal aid overstate the decline in total (direct and indirect) Federal assistance to local governments. At the same time, simple trends in State aid overstate the increase in State-raised revenues that go to local governments.

Own-Source Revenues

Growth in own-source revenues allowed many local governments to increase their spending at a time of reduced Federal aid. It also made local governments more self-reliant by reducing their reliance on Federal and State aid. Most now have a more balanced revenue system, putting more reliance on user charges and less on the property tax that has been unpopular with voters and shrinking as a revenue source over the long run.

Not all areas participated equally in these developments. Areas with the greatest increase in revenue efforts (urbanized and less urbanized independent nonmetro and less urbanized dependent nonmetro) reduced their real property taxes per capita less than most other metro and nonmetro areas (table 7).[19] The least property tax relief (-$6 per capita), however, was in totally rural dependent areas. Totally rural independent areas also had relatively little property tax relief.

One result of this trend was that for the first time, local governments in most areas depend on the property tax for less than half of own-general revenues (fig. 7). The major exception was totally rural areas, which still receive almost 60 percent of their own-general revenues from property taxes, and fringe metro areas, whose property tax dependency is 54 percent.

This could become a problem later if totally rural governments come under increasing taxpayer pressure to cut property taxes. State action would be required in most places to provide a more balanced revenue system for local governments, since current State laws tend to restrict local governments from raising revenues from income and sales taxes.

A high property tax dependency may have certain advantages for some rural governments. It may allow some totally rural governments to export or shift more of their taxes to urban residents (those who own farms or vacation cottages in rural jurisdictions) than would be possible if they relied more on income and sales taxes, which are paid mainly by local residents (20). During times of acute economic difficulty (such as the recent farm crisis), the property tax base may prove to be relatively resilient to short-term fluctuations due to

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[19] This may reflect the lag in rural assessed property values which continue to increase (or decrease only slightly) after incomes begin to fall (19).

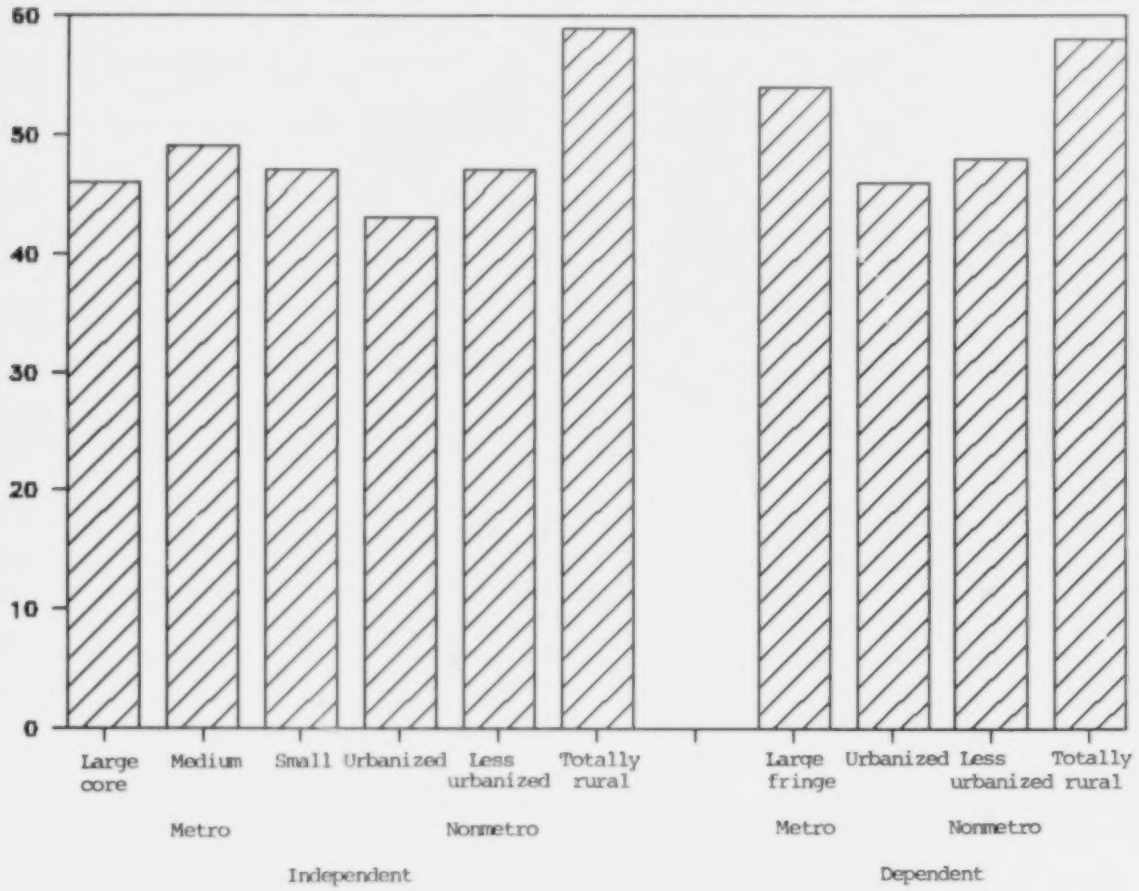
Table 7—Own-source revenues per capita by areas, 1982 1/

Type of area	Total	Tax revenues					Nontax revenues			
		Total	Property	General sales	Income	Other	Total	User charges and fees	Utility and liquor revenues	Other
					Dollars					
Independent:										
Metro—										
Large core	983	519	375	52	31	60	464	187	142	134
	(-5)	(-117)	(-126)	(6)	(2)	(1)	(112)	(20)	(29)	(63)
Medium	645	325	261	32	8	24	320	133	107	79
	(40)	(-36)	(-35)	(3)	(-3)	(-2)	(76)	(24)	(18)	(34)
Small	656	307	248	30	4	24	350	152	113	84
	(44)	(-28)	(-33)	(5)	(0)	(.1)	(72)	(22)	(15)	(35)
Nonmetro—										
Urbanized	769	312	257	32	2	21	457	189	167	100
	(76)	(-25)	(-34)	(8)	(-.3)	(2)	(101)	(30)	(32)	(39)
Less urbanized	761	336	296	22	2	16	424	181	138	104
	(98)	(-15)	(-21)	(7)	(-.3)	(-1)	(113)	(38)	(21)	(54)
Totally rural	763	448	420	12	.2	15	315	141	78	96
	(81)	(-18)	(-23)	(4)	(0)	(.4)	(99)	(33)	(24)	(42)
Dependent:										
Metro, large fringe	710	423	350	31	14	27	287	126	70	91
	(9)	(-55)	(-59)	(7)	(1)	(-4)	(65)	(17)	(7)	(40)
Nonmetro—										
Urbanized	667	315	253	35	8	19	352	152	122	78
	(25)	(-43)	(-45)	(4)	(-1)	(-1)	(68)	(27)	(12)	(29)
Less urbanized	624	293	251	23	3	16	330	145	105	80
	(74)	(-11)	(-16)	(6)	(-.4)	(-.1)	(85)	(27)	(22)	(37)
Totally rural	565	337	304	14	3	16	228	92	47	89
	(46)	(-4)	(-6)	(4)	(.1)	(-2)	(49)	(12)	(7)	(31)

1/ 1977-82 changes in per capita revenues are in parentheses and are expressed in 1982 constant dollars.

Figure 7--Property tax dependency, 1982 1/

Percent



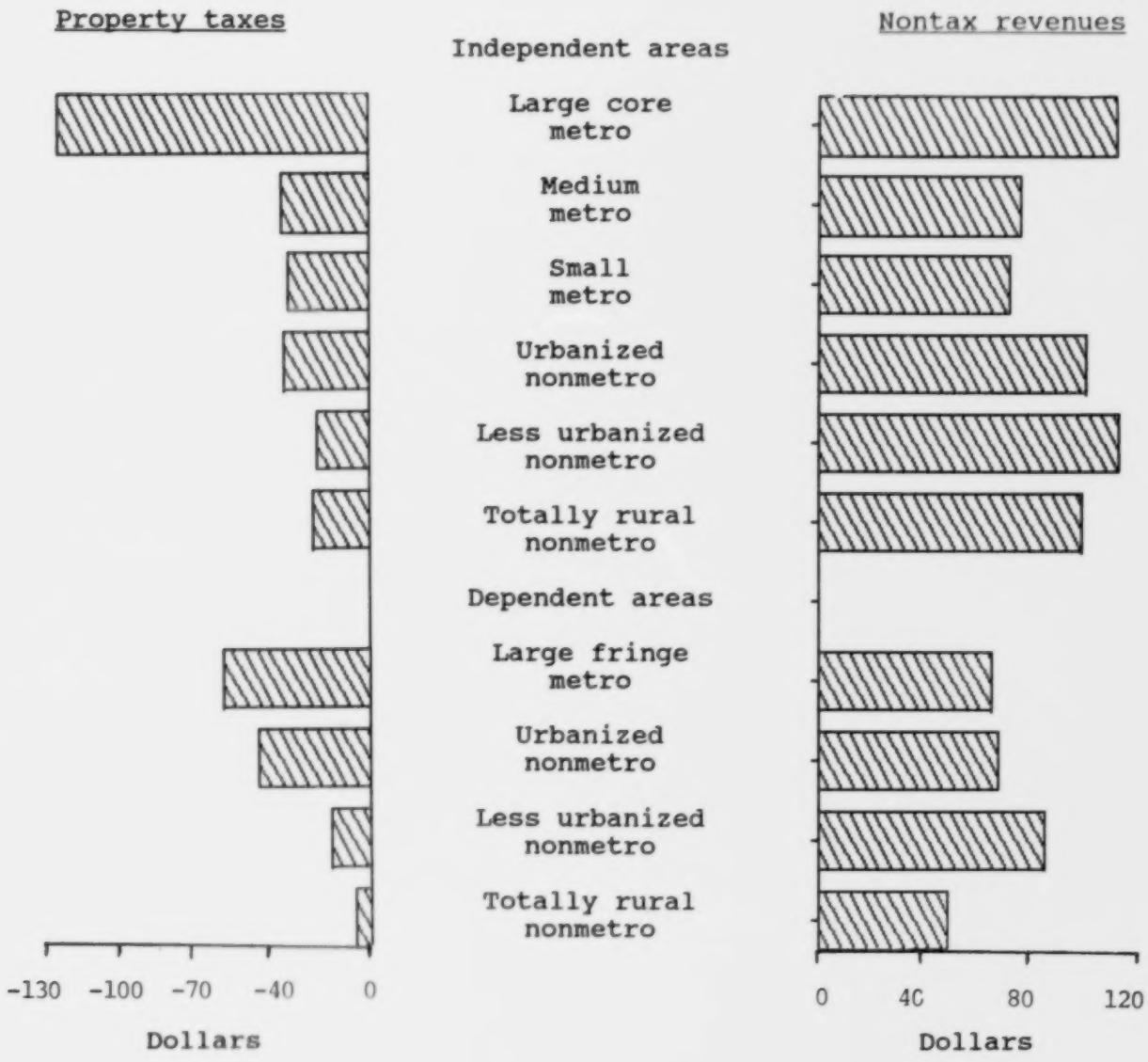
1/ Property taxes as percentage of own-source general revenues

legal constraints on changes in assessed property values and the relative ease with which property tax rates may be changed. Although some recent studies have shown property tax delinquency rates to have risen in communities heavily affected by the farm crisis, there is little evidence to suggest that this has created major fiscal difficulties for rural local governments (19).

Core metro areas stand out over all other areas in terms of property tax relief during 1977-82; their property taxes declined by $126 per capita (fig. 8). Much of this probably reflects the effects of proposition 13 and similar movements across the country. Although fringe metro areas (the suburbs of core metro areas) benefited the least from property tax relief, their tax limitation movement was strongest. The explanation for the larger property tax relief in core metro counties may lie in their more rapidly growing economies, which allowed them to increase user charges and other nontax revenues more than fringe metro areas.

User charges and fees increased most in independent nonmetro areas, which needed funds to finance their rapid growth in spending. The growth of user charges in nonmetro areas may be partly responsible for survey findings that the popularity of user charges has declined recently, and that rural Americans show less preference for this source of revenue than urban Americans (22).

Figure 8--Trends in own-source revenues, by area *



* 1977-82 changes in 1982 dollars per capita.

Most of the revenue growth for both urban and rural governments was in the "other" category, which includes interest earnings, special assessments and reimbursement for capital outlay, sale of property, and other miscellaneous general revenue. A substantial portion of the increase was in interest earnings, which grew largely because of high interest rates in the early eighties. The decline in interest rates in the mideighties may have diminished this category as a major source of new revenue.

Rural governments in the future may encounter increasing difficulty in raising nontax revenues to offset property tax reductions. Some rural communities may be coming to a point of saturation when no more public services can be charged to users, or they may face opposition to increasing the rates of user charges on public services. Some rural places may already be saturated. For example, independent urbanized and less urbanized areas already pay per capita user charges and fees on a level comparable with that of core metro areas. Core metro areas provide a broader range of public goods and services to which user charges may be applied and have more resident and commuter income to pay for these charges than do nonmetro areas. User charges also tend to be "regressive" in that they take up a larger proportion of the incomes of the poor than of the rich. This socially perceived inequity could also serve to limit the growth of user charges in rural areas.

LOCAL GOVERNMENT DEBT

Trends in government debt point to several important fiscal developments for rural and urban governments. First, nonguaranteed long-term general debt increased substantially, reflecting the rapid growth in publicly subsidized private sector development. Second, guaranteed long-term general debt declined significantly, reducing the exposure of local governments to default. Third, some nonmetro areas experienced significant increase in long-term utility debt, reflecting the growth of these independent, special-purpose districts. Because each type of debt is functionally distinct, having its own unique fiscal implications for local governments, it makes little sense to speak of total indebtedness. Each must be examined separately to gain meaningful insights.

Per Capita Debt Outstanding

Most of the growth in local government debt in recent years has been in the form of long-term general nonguaranteed debt. Included in this category are mortgage revenue bonds, pollution control bonds, and industrial revenue bonds. This is mostly private-purpose debt: tax-exempt debt issued in the name of local governments to obtain below-market interest rate financing for facilities servicing particular firms or individuals. Because local governments do not promise to repay the debt from general funds (that is, it is not backed by the "full faith and credit" of the governments), this addition to government debt does not directly add to government borrowing costs or to exposure to default.[20] This has been a favorite method by which local governments have attempted to spur economic development. Less of this kind of activity is expected in the future since the passage of strict volume limits (caps) on private purpose debt was part of the 1986 tax reform legislation.

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[20] Government borrowing costs and exposure to default can increase indirectly as a result of growth of this kind of debt because of the additional financial burden placed on the local economy.

Private purpose debt increased by over $100 per capita in most urban and rural areas during 1977-82. The largest increases occurred in nonmetro areas (urbanized independent and less urbanized dependent areas) (fig. 9). Totally rural areas, both independent and dependent, used this form of economic development assistance less, increasing their nonguaranteed general debt by $80 and $38 per capita, respectively (table 8). Even the $80-per-capita increase in totally rural independent areas was significant, because this almost doubled the amount of nonguaranteed general debt that was outstanding for these rural areas.[21]

Trends in guaranteed long-term general debt are more directly relevant to the fiscal position of local governments. Backed by the full faith and credit of the local government, guaranteed debt implies a more significant fiscal commitment than nonguaranteed debt. The large decline in guaranteed debt for urban and rural areas from 1977-82 improves their fiscal situation, reducing the chances of default. This decline in real guaranteed general debt is mostly due to the relatively high rate of inflation.[22] It represents one of the ways in which inflation has benefited local governments.

The lower guaranteed debt level should result in improved credit ratings and reduced borrowing costs for both urban and rural governments, other things being equal. However, other things were not equal during this period. The substantially larger reductions in guaranteed debt for large metro areas (core and fringe) might have improved government bond ratings for big cities relative to small cities and rural governments. If this occurred, it would encourage the purchasers of guaranteed government debt to shift from small to large bond issuers, possibly causing rural governments to pay higher borrowing costs.[23]

Such a shift in demand from urban to rural bonds would be expected to compound the problem small governments already face in the bond market. A recent study examining the 1982 bond market showed that bond offerings of highly rural governments tend to be either unrated or rated lower than bonds of more urban governments. These characteristics should cause rural governments to have higher borrowing costs. It is not surprising that this cross-sectional analysis found that the average interest cost for guaranteed general debt generally

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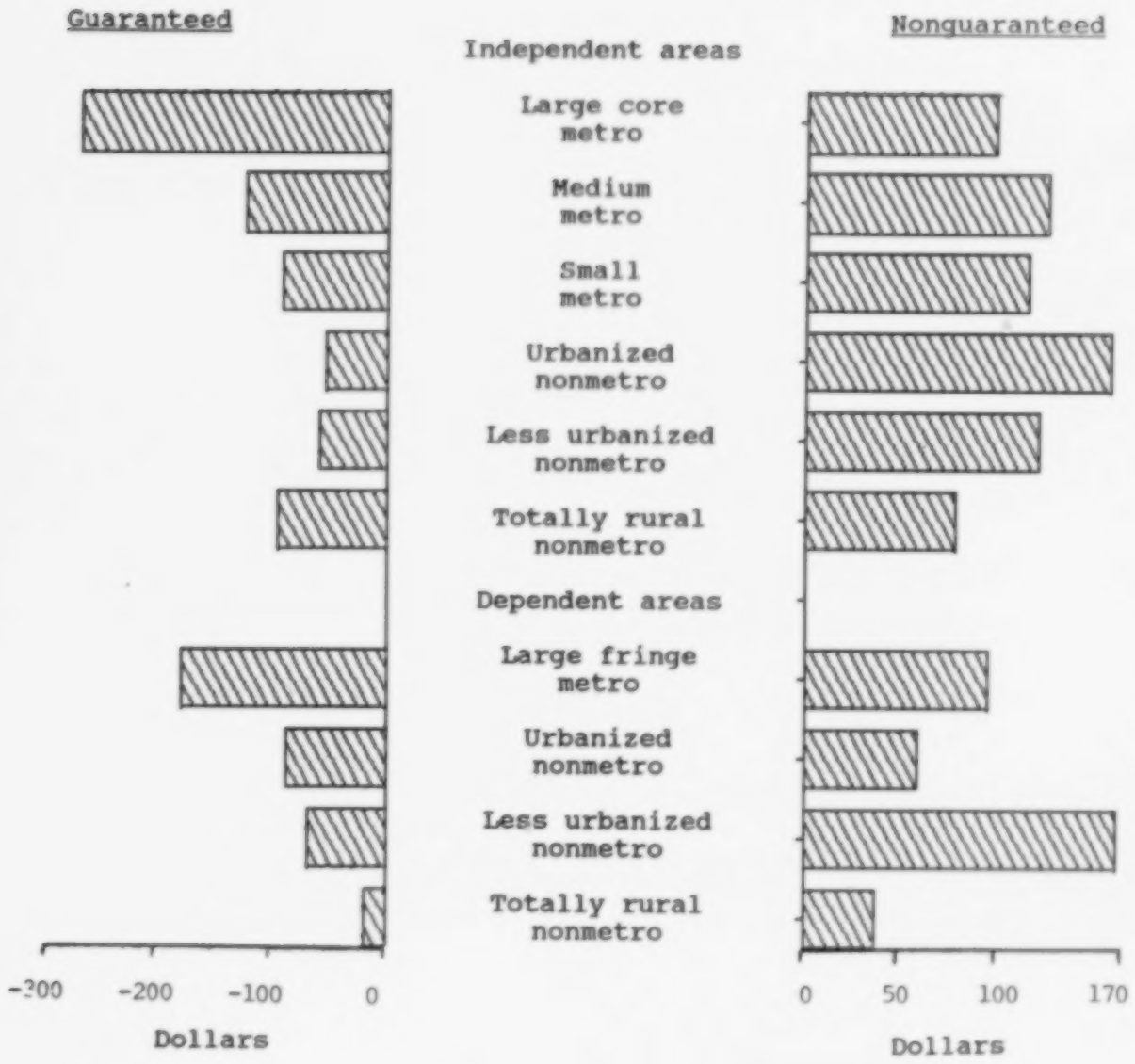
[21] The figures for totally rural areas may not be very accurate because the smallest municipalities and townships only reported a single debt total on census surveys. Census collects more detailed debt information from county governments, school districts, special districts, and larger cities. County area totals are based on these data.

[22] This is possible because debt outstanding at the beginning of the period was much larger than net debt incurred during the period; consequently, while inflation added to the amount of net new debt incurred, this was more than offset by the reduced real value of debt outstanding associated with inflation.

[23] One recent study argues that such a shift from small issues to large issues occurred between 1974 and 1984. According to this study, this trend only exacerbates the cost disadvantage small issuers already face in the bond market because of the inverse relationship between bond issue size and interest cost (6).

Figure 9--Trends in long-term general debt outstanding, by area *



* 1977-82 change is in 1982 dollars per capita.

Table 8—Debt outstanding, per capita and ratios, 1982 1/

Type of area	Per capita debt				Ratios 2/	
	Long-term general		Long-term utility	Short-term	Debt/revenue	Debt/income
	Guaranteed	Nonguaranteed				
	Dollars				Percent	
Independent:						
Metro—						
Large core	452	475	334	96	32	3.7
	(-267)	(101)	(6)	(6)	(-18)	(-2.5)
Medium	312	359	171	58	34	3.2
	(-123)	(129)	(-4)	(9)	(-11)	(-1.3)
Small	307	358	164	21	32	3.1
	(-91)	(118)	(-18)	(-4)	(-10)	(-1.1)
Nonmetro—						
Urbanized	283	444	259	34	28	3.0
	(-52)	(162)	(34)	(11)	(-6)	(-0.6)
Less urbanized	271	330	159	18	26	3.1
	(-58)	(124)	(-2)	(1)	(-8)	(-0.8)
Totally rural	263	179	245	11	22	3.0
	(-95)	(80)	(169)	(3)	(-14)	(-1.5)
Dependent:						
Metro, large fringe	380	317	125	55	37	3.4
	(-179)	(97)	(-28)	(12)	(-16)	(-1.9)
Nonmetro—						
Urbanized	250	294	152	35	26	2.7
	(-88)	(60)	(-8)	(-1)	(-8)	(-0.9)
Less urbanized	243	324	155	22	26	2.8
	(-69)	(166)	(38)	(7)	(-8)	(-0.9)
Totally rural	274	168	69	15	28	3.4
	(-19)	(38)	(-10)	(7)	(-4)	(-0.4)

1/ For per capita debt, 1977 to 1982 changes expressed in 1982 constant dollars. For ratio indicators, 1977 to 1982 is the change in the ratio expressed in percentage points. 1977-82 changes are in parentheses.

2/ Both ratios are for long-term general guaranteed debt and are expressed in percentage terms. General revenues are used in the debt/revenue ratio; resident personal income is used in the debt/income ratio.

increased with rurality, and that highly rural governments paid the highest interest costs (11).[24]

Other developments of the late seventies and early eighties (such as the general rise in inflation and interest rates and the increased perception of the riskiness of public investments caused by publicity over the default of the Washington Public Power Supply System) contributed to record-high interest costs for local government borrowing (11, pp. 1-2). Adding to the costs of guaranteed general borrowing was the growth in the supply of private purpose government debt, which meant additional competition for traditional public purpose debt in the tax-exempt bond market.

The decline in guaranteed general debt may be viewed as a necessary response to adverse developments in the bond market, rather than a beneficial fiscal development. One should not overlook the fact that declining long-term general debt implies declining capital investment in public infrastructure--which may itself have adverse consequences for future economic development. This point is underscored by the observation that the places with the greatest decline in guaranteed general debt (core metro, fringe metro, and medium metro) also had the greatest decline in capital spending.

Independent totally rural areas stood out for their rapid increase in long-term utility debt, an increase of $169 per capita in debt outstanding. This debt is usually financed by revenue bonds, mostly nonguaranteed, with earmarked revenues from utility charges. Independent urbanized and dependent less urbanized areas also had sizable, though much smaller, increases in utility debt.

Rural areas with growing utility debt also experienced higher than average increases in utility revenues. This may be a beneficial development for many rural areas that require water and electric utilities to encourage development. Some local governments actually profit from utility revenues, using the utility's surplus revenues (an excess of revenues over costs) to replace general revenues. But rising utility debt and utility revenues may also place added strain on community resources. The inability of some low-income rural communities to afford higher utility fees may prevent them from obtaining credit and, thus, prevent the construction of utilities.

Real short-term debt increased for most places, indicating some degree of short-term fiscal difficulty. It increased the most for fringe metro areas and independent urbanized nonmetro areas. However, short-term debt (defined as debt that matures in less than 1 year) remained relatively small for most governments. Short-term debt is less significant as rurality increases, and it does not seem to be much of a problem for most nonmetro governments.

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[24] A previous study found nonmetro governments actually had a slight interest cost advantage over metro governments (21). This finding was based on weighted-averages of interest costs for metro and nonmetro aggregates in 1977. No distinction was made between core metro places, which issued large amounts of debt at relatively high interest costs (especially in the seventies), and small and medium metro areas, which tend to have much lower interest costs. The metro category's higher interest costs probably were due to the heavy weight given to core metro areas and did not reflect interest costs for the typical metro area.

Debt-Burden Ratios

Two ratios can be used to measure the burden of debt outstanding on local government budgets and community income. Guaranteed general long-term debt outstanding as a percentage of local government's general revenues indicates budget inflexibility associated with the need to pay debt service costs. Governments with high debt/revenue ratios must apportion a larger share of their general revenues to service their debt. In times of fiscal crisis, a high debt/revenue ratio may force the local government to default on its debt or cut back on public services financed by general revenues.

Guaranteed general long-term debt outstanding as a percentage of local income measures the debt-imposed burden on taxpayers. If this burden increases noticeably, it may make it difficult for governments to get voter approval of government bond offerings to finance capital projects. High debt/income ratios may also result in lower credit ratings, increasing borrowing costs due to the increased likelihood of default.

As a result of the inflation-induced depreciation of real long-term general debt, most local governments benefited from reduced debt ratios from 1977-82. The largest decline in debt ratios was in core and fringe counties of large metro areas and in independent totally rural areas. These places benefited most from rising fiscal capacities, which probably enabled them to write off more of their debt, while raising more general revenues to support the debt.

This trend toward greater debt reduction at the ends of the urban-rural spectrum has brought about more parity in debt burdens among governments of different degree of urbanization. A U-shaped urban-rural pattern existed for the debt/income ratio for 1977. This had flattened out considerably by 1982, and only core metro areas now stand out with a debt/income ratio higher than other categories (fig. 10). Relative to other areas, core metro areas have nevertheless reduced their debt ratios considerably, enhancing their position in the credit markets.

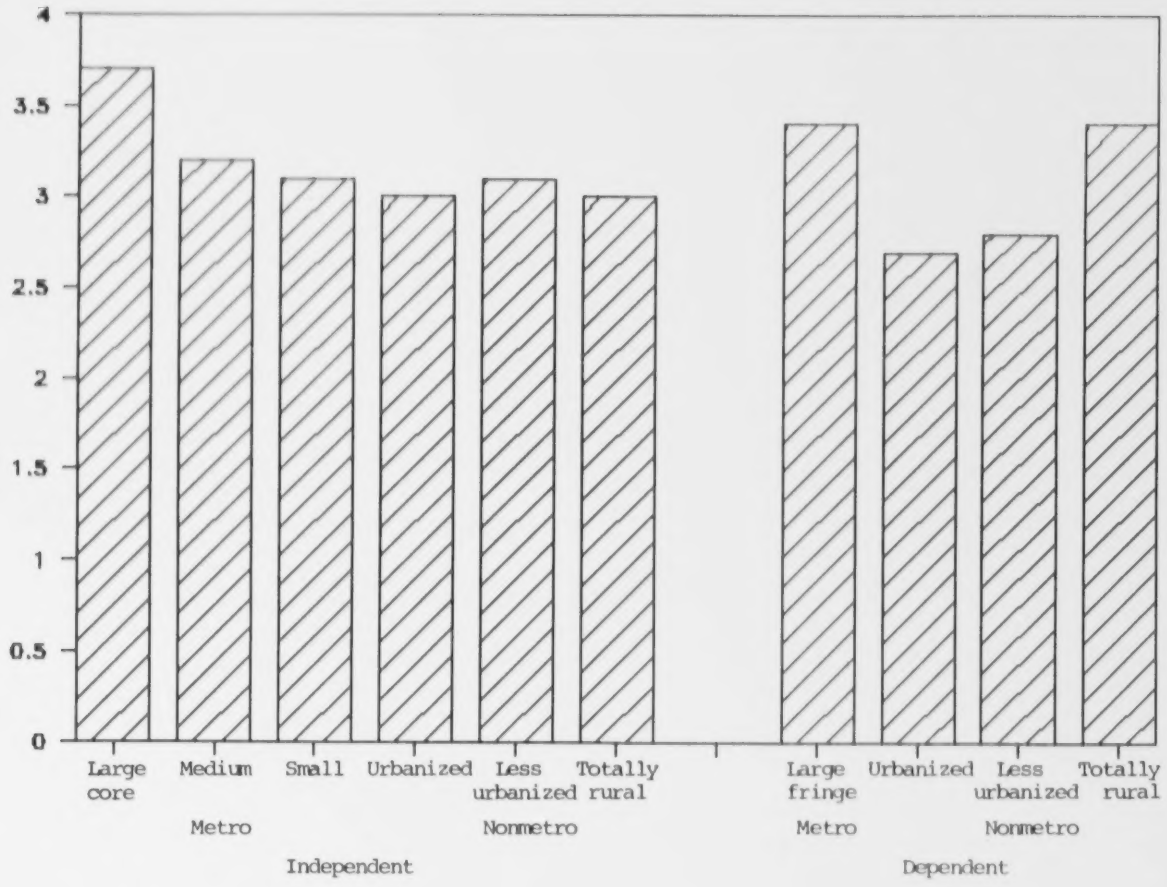
CONCLUSIONS AND IMPLICATIONS

Despite great concerns in the early eighties over the ability of local governments to maintain spending levels while facing the recession of 1981-82 and declining Federal aid, most managed to increase real government spending over the 5-year period (1977-82). Although there were some signs of potential fiscal stress (such as rising revenue efforts in rural areas and declining real current spending in large metro areas), the worst case scenario of both rising revenue efforts and reduced real spending did not characterize any of the urban and rural categories of governments.

Fiscal capacity, measured by real per capita income, increased for local governments nationwide. There were major variations among categories of urban and rural areas. The most notable difference was that the places at the urban and rural extremes (large metro and totally rural) benefited much more from rising fiscal capacities than areas in the middle of the urban-rural spectrum.

Most nonmetro places reduced their real spending on highways and welfare. Nevertheless, many nonmetro areas, urbanized and less urbanized areas in particular, had to increase their revenue efforts substantially in order to pay for rapidly growing expenditure on other functions at a time of slow growth in fiscal capacity.

Figure 10--Debt as percentage of income, 1982 1/



1/ Long-term guaranteed general debt outstanding as percentage of resident personal income.

Reduced revenue efforts for large metro areas, coming at a time when small metro, medium metro, and most nonmetro areas experienced rising revenue efforts, may have improved big cities' competitive position for future economic development. Although the competitive position of some nonmetro areas might have improved from the additional public services financed by higher revenue efforts, many less urbanized and totally rural independent nonmetro areas now have revenue efforts that are even higher than those of large metro areas. Additional increases in revenue efforts might present a problem for these areas in attracting industry or individuals sensitive to high tax rates.

The "tax revolt" and the "baby bust" of the mid- and late seventies may be reflected in some major changes in the revenue structure of both urban and rural local governments. Many urban and rural governments appear to have taken advantage of reduced education costs and rising fiscal capacities to cut spending on education and provide substantial property tax relief to taxpayers. The development of new nontax sources of revenue made it easier to reduce property taxes. This more balanced revenue system may reduce local government exposure to budgetary uncertainties associated with future tax revolts.

Budget uncertainties were further reduced as a result of the decline in real Federal aid. Most local governments by 1982 had become less dependent on direct

Federal aid, and, hence, the budgetary shock from subsequent Federal aid cuts was reduced.

Both urban and rural governments shared in a general decline in guaranteed general debt, which reduced their exposure to potential default and should improve their bond ratings. At the same time, local governments were increasing their use of tax-exempt nonguaranteed debt, such as industrial revenue bonds and mortagage revenue bonds, to encourage private sector development activities.

Some Surprising Findings

Although 1982 (the end year for the period) was the trough of a major recession, fiscal capacity indicated by real per capita income increased in 1977-82 for all of the urban and rural categories nationwide. This underscores the importance of long-term economic growth in the finances of local governments.

This is not to say that there were no signs of the recession's impact in the 1977-82 fiscal trends. In many areas, there were noticeable reductions in real capital spending (one of the first things cut in times of tight budgets). Some reductions were due to reduced school construction associated with the baby bust, reduced Federal aid for highways, and reduced borrowing because of high interest rates. Some reductions in capital spending were probably a consequence of local governments postponing infrastructure projects until a later phase in the business cycle. Further reductions in spending might have been observed if the study period had included 1983, because spending reductions tend to occur in the beginning of the recovery phase of business cycles (26).

The large reductions in real current spending from 1977-82, which occurred mainly in big cities in the Northeast and the West, probably were not linked to the recession. They were probably linked to changing priorities, as most of these areas benefited from increased fiscal capacities and appear to have used this occasion to provide tax relief--possibly as a consequence of tax revolt. Although spending cuts were made in other areas less affected by tax revolt, most of these real spending cuts were in education, which benefited from declining student enrollment and reductions in real teachers' salaries.

Another surprising finding is that fiscal capacity and government spending increased more rapidly in independent than in dependent nonmetro areas. During the seventies, dependent areas had more population growth and had been considered in better economic shape than independent nonmetro areas (8). Among independent nonmetro areas there was a further surprise in that the category (totally rural) with the greatest increase in fiscal capacity had a somewhat smaller increase in current government spending. Totally rural independent areas were in the worst fiscal position in the midseventies, having both high and rising revenue efforts. But with the help of their large increase in fiscal capacity and some restraint in spending, these areas were able to keep their revenue efforts from rising in 1977-82.

Most independent nonmetro areas substantially increased their current spending. Much of the growth in spending was in health and hospitals, utilities, sewage and sanitation, and other public services with relatively large increases in costs. Both independent and dependent nonmetro areas had larger increases in these expenditures than metro areas, possibly reflecting the need to "catch up" in providing services to the many new inmigrants in nonmetro areas during the seventies, some of whom demand special services (such as the elderly). Dependent nonmetro areas may have benefited from the availability of some of

these services in nearby metro areas, which might explain why dependent nonmetro spending did not increase as fast as independent nonmetro areas.

A third surprising finding concerned State and Federal aid. Local government officials almost uniformly complained of aid reductions during this period. But the aid trends differed substantially from area to area in a way that appears to have mitigated longstanding differences in fiscal conditions. For areas generally thought to be in good fiscal condition (such as medium metro, small metro, and urbanized dependent nonmetro areas), real State aid (including Federal pass-through) declined. For core metro and independent nonmetro areas, which are generally considered to be in worse fiscal condition, real State aid increased, with the largest increase going to totally rural independent areas. Totally rural independent areas, other independent rural areas, and totally rural dependent areas also benefited from a surprising increase in real direct Federal aid, other than revenue sharing, while other urban and rural areas experienced declines in this form of Federal aid.

Implications

These trends for 1977-82 may help us understand the implications of more recent fiscal trends. The effects of short-term economic difficulties on local governments should not be overstated. Although local governments may temporarily suffer acute short-term difficulties from such problems as fluctuating farm and energy prices, changes in the value of the dollar and interest rates, and economic recessions, this report suggests that unless such problems persist for more than a few years or coincide with other, more long-term difficulties, their effect on the provision of local public services may be relatively insignificant.

Long-term trends in income, employment, and property values are probably more important to local government fiscal condition than year-to-year fluctuations. The relatively large 1977-82 increase in fiscal capacity for many large metro areas allowed them to provide property tax relief during 1977-82, making it less likely that they will face another round of tax revolt in the near future. In contrast, the relatively small increase in fiscal capacity in many urbanized and less urbanized nonmetro areas, together with the rapid increase in spending on current services in these places, reduced the extent to which they could lower property taxes. Their rising revenue efforts during 1977-82 and relatively high property tax dependencies make them more susceptable to taxpayer resistance as the eighties progress.

Local government spending increases may have enhanced the quality of life in many nonmetro areas, but revenue efforts in highly rural areas now exceed those of large central cities. If these trends continue, the danger exists that more businesses and individuals may choose to remain or relocate in the big cities to avoid the high tax burdens of rural areas. Local government officials in particularly high-tax areas might look for ways to economize in the provision of public services to reduce tax burdens without reducing the level of public services.

It appears that some of yesterday's fiscal solutions are becoming today's fiscal problems. For example, the tendency of local governments to hold the line on teachers' salaries during the late seventies and early eighties may have helped local governments provide property tax relief and avoid cutting essential services. However, this may have contributed to today's widely recognized education crisis, which is now forcing many local governments to increase

teachers' salaries, possibly at the expense of raising taxes or reducing spending on other public services.

Two other expedient fiscal trends during the late seventies and early eighties could present problems for local governments in the future. First, the reduced reliance on property taxes and increased reliance on user charges may have negative consequences for the equity of local revenue systems and may reduce rural areas' ability to export taxes to nonresidents. Second, industrial revenue bonds and other private purpose debt issued in the name of local government to finance private sector development increased in the early eighties. Because of the large cost to the Federal Treasury, greater restrictions have been placed on the use of tax-exempt bonds to finance both private and public sector facilities. In the case of the latter, this may possibly lead to higher borrowing costs for many small local governments (3).

The gradual decline in Federal aid, which occurred during the late seventies and early eighties, may be making it easier for local governments to adjust to the subsequent termination of Federal aid programs, such as General Revenue Sharing. Inflation had already eroded half the real value of GRS by 1982 so that the shock of its termination in 1986 was reduced considerably. Local governments in nonmetro areas today rely directly on the Federal Government for only 5 percent of their revenue, and many receive no Federal aid at all.

The shift from direct Federal aid to block grants to States has forced local government officials to look more to their State governments for assistance. This may be viewed as a healthy development because States dictate the rules under which local governments finance their public services. State aid (including Federal pass-throughs) now accounts for over 30 percent of total local revenue, about 40 percent for totally rural areas. The shift from Federal to State aid may become a problem for local governments in some rural States whose economies or tax bases are inadequate to support the most basic of local government services. Current variations in State aid and the distribution of Federal block grants to States deserve more attention, as does the question of how rural and urban governments fare under this process of fiscal decentralization.

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APPENDIX

This appendix provides a regional breakdown for six key fiscal indicators: current spending per capita, capital spending per capita, fiscal effort (revenue effort), fiscal capacity (resident personal income per capita), direct Federal aid per capita, and State aid per capita. It is useful not only as a means of evaluating the robustness of the conclusions drawn from the national average data in the main body of this study, but also as a view to how fiscal difficulties and fiscal solutions differ from one region to another.

A major conclusion of this study is that there was little evidence of the worst case scenario of both declining spending and rising revenue effort having come about as a consequence of economic recession and declining aid. This is an important conclusion because neither a decline in spending nor a rise in revenue effort is in itself proof of fiscal difficulty. A decline in spending could be associated with a deliberate decision to reduce the size or eliminate inefficiencies of the public sector, or it could simply reflect declining demand for certain public services, as occurs when school enrollment declines. An increase in local revenue effort could be associated with a deliberate decision to increase the level of public services or with reduced Federal and State tax burdens reflecting a shift of responsibilities from higher to lower levels of government. But, if a combination of a decline in spending and a rise in revenue effort were observed, no such arguments could negate the conclusion that the observed pattern reflects actual fiscal stress.

None of the urban and rural categories displayed such a combination of fiscal difficulties when the indicators were computed for the average county. If one goes beyond the national average and examines urban and rural categories within regions, few examples of this worst case scenario may be found, and there are signs that things are not as bad as they would seem.

Dependent urbanized nonmetro areas in the North Central region displayed several "worst case" characteristics, including a $10 decline in real current spending per capita (app. table 1), a 0.5-percentage-point increase in revenue effort, and a $305-per-capita decline in fiscal capacity (app. table 2). Upon closer inspection, however, it appears that declining income is causing revenue efforts to rise. The reduction in current spending was quite small, and capital spending actually increased for these places.

Elsewhere in the North Central region, dependent totally rural areas experienced more substantial reductions in current spending. This does not appear to be the ult of economic difficulty. Fiscal capacity actually increased substantially these places. The reduction in spending may therefore be related to reduced ol enrollment or reduced aid. The combination of declining fiscal capacity and increasing fiscal effort is most evident in three of the four metro categories and in two of the three dependent nonmetro categories in the region.

Appendix table 1—Per capita current and capital spending by region, 1982 1/

Type of area	Current expenditures 2/				Capital expenditures			
	Northeast	North Central	South	West	Northeast	North Central	South	West
				Dollars				
Independent:								
Metro—								
Large core	1,356	1,286	1,016	1,426	191	221	304	261
	(-75)	(5)	(25)	(-67)	(22)	(-43)	(-53)	(-27)
Medium	957	931	772	1,157	122	136	120	197
	(-67)	(-1)	(44)	(-57)	(-15)	(-30)	(-39)	(-33)
Small	820	894	796	1,070	79	160	133	193
	(-43)	(23)	(32)	(1)	(-83)	(-24)	(-17)	(-40)
Nonmetro—								
Urbanized	1,178	904	909	1,106	137	195	139	229
	3/(18)	(-12)	(100)	(96)	3/(24)	(31)	(13)	(-51)
Less urbanized	794	1,083	795	1,169	116	173	104	244
	(-8)	(45)	(63)	(101)	(-7)	(-48)	(-19)	(36)
Totally rural	775	1,039	728	1,327	65	143	146	266
	3/(-83)	(48)	(27)	(111)	3/(-66)	(6)	(27)	(32)
Dependent:								
Metro, large fringe	1,008	844	794	1,100	113	119	132	224
	(-88)	(-7)	(14)	(-73)	(-30)	(-29)	(-52)	(3)
Nonmetro—								
Urbanized	885	898	854	1,031	119	170	134	136
	(-81)	(-10)	(69)	(15)	(-35)	(20)	(-44)	(-50)
Less urbanized	867	896	773	1,171	132	142	123	197
	(-48)	(1)	(53)	(58)	(-8)	(6)	(-1)	(4)
Totally rural	854	876	704	1,252	107	126	107	212
	3/(-140)	(-67)	(53)	(63)	3/(14)	(23)	(4)	(-45)

1/ 1977-82 changes in per capita expenditures are in parentheses and are expressed in 1982 constant dollars.
2/ Excludes interest and other miscellaneous expenditures.
3/ Fewer than 10 counties in the category.

Appendix table 2—Per capita fiscal effort and capacity by region, 1982 1/

Type of area	Fiscal effort				Fiscal capacity			
	Northeast	North Central	South	West	Northeast	North Central	South	West
	Percent				Dollars per capita			
Independent:								
Metro—								
Large core	7.1	7.3	6.5	6.9	12,343	12,046	11,690	12,761
	(-1.5)	(.1)	(.2)	(-1.4)	(775)	(83)	(902)	(456)
Medium	6.0	6.0	4.9	6.1	10,494	10,406	9,190	10,728
	(-.4)	(.5)	(.3)	(-.9)	(392)	(-231)	(308)	(140)
Small	5.4	5.8	5.3	6.2	9,836	10,054	9,309	10,205
	(-.4)	(.5)	(.3)	(-.7)	(428)	(-58)	(248)	(-166)
Nonmetro—								
Urbanized	7.8	6.3	6.1	7.1	8,396	9,846	8,791	9,584
	2/(.4)	(.2)	(.8)	(.4)	2/(303)	(10)	(71)	(-38)
Less urbanized	6.1	7.5	5.6	8.5	9,030	9,510	7,886	9,222
	(.1)	(.6)	(.5)	(.4)	(219)	(224)	(130)	(240)
Totally rural	7.1	7.9	5.3	11.0	8,878	9,426	7,392	8,905
	2/(.2)	(-.2)	(.2)	(-.2)	2/(191)	(941)	(283)	(483)
Dependent:								
Metro, large fringe	5.9	5.8	5.4	5.9	12,869	10,566	10,944	12,632
	(-1.1)	(.4)	(-.1)	(-1.6)	(1,032)	(-3)	(689)	(1,085)
Nonmetro—								
Urbanized	5.9	6.3	5.3	5.8	9,692	9,871	9,001	9,192
	(-.4)	(.4)	(.5)	(-.8)	(286)	(-305)	(220)	(-241)
Less urbanized	6.7	6.4	5.4	7.5	8,475	9,116	8,216	8,950
	(.5)	(.6)	(.5)	3/	(186)	(-254)	(322)	(-86)
Totally rural	7.4	6.6	4.9	8.8	8,223	8,700	7,738	9,071
	2/(-.4)	(.1)	(.4)	(-1.7)	2/(-70)	(345)	(422)	(605)

1/ Fiscal effort is own-general revenue effort, as defined in table 4. Fiscal capacity is resident personal income per capita, in 1982 dollars. 1977-82 changes are in parentheses.

2/ Fewer than 10 counties in the category.

3/ Less than 0.1-percentage-point increase.

Appendix table 3—Per capita Federal and State aid by region, 1982 1/

Type of area	Direct Federal aid				State aid (includes pass-through) 2/			
	Northeast	North Central	South	West	Northeast	North Central	South	West
	Dollars per capita							
Independent:								
Metro—								
Large core	163	161	128	123	572	426	347	614
	(-15)	(-19)	(-42)	(-40)	(47)	(-28)	(-7)	(57)
Medium	60	60	55	79	409	348	297	538
	(-32)	(-16)	(-22)	(-31)	(-42)	(-40)	(-12)	(22)
Small	61	77	61	77	292	363	302	507
	(-53)	(4)	(-14)	(-23)	(-20)	(-19)	(-10)	(56)
Nonmetro—								
Urbanized	82	71	66	96	544	315	320	485
	3/(-5)	(-7)	(-5)	(-10)	3/(-51)	(-25)	(-6)	(64)
Less urbanized	61	55	50	89	303	370	344	503
	(-11)	(-8)	(-15)	(4)	(-39)	(-13)	(8)	(63)
Totally rural	44	58	50	91	243	345	384	537
	3/(-42)	(3)	(-18)	(8)	3/(-20)	(25)	(13)	(35)
Dependent:								
Metro, large fringe	45	45	52	60	353	332	278	454
	(-38)	(-7)	(-16)	(-20)	(2)	(-27)	(-22)	(41)
Nonmetro—								
Urbanized	64	53	53	72	381	348	313	501
	(-27)	(-16)	(-28)	(-27)	(-58)	(-24)	(-1)	(41)
Less urbanized	50	46	50	84	382	364	344	548
	(-15)	(-8)	(-13)	4/	(-61)	(-30)	(-1)	(50)
Totally rural	30	44	46	67	302	387	364	567
	(-49)	(-3)	(-10)	(11)	3/(-95)	(-28)	(7)	(55)

1/ 1977 to 1982 change in per capita aid expressed in 1982 constant dollars. 1977-82 changes are in parentheses.
2/ Pass-throughs are Federal grants to States that are passed through to local governments.
3/ Fewer than 10 counties in the category.
4/ Less than $0.50 change per capita.

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None of these areas exhibited significant declines in current spending, though capital spending was cut substantially in some of these areas.

In the West, four categories in the middle of the urban-rural spectrum experienced declining fiscal capacity (small metro, independent urbanized, adjacent urbanized, and dependent less urbanized). None of these areas had to cut current spending, and, in some cases, their revenue efforts actually declined. Increased State aid helped to avoid adverse fiscal consequences (app. table 3).

Outside of the North Central and Western regions, fiscal capacity increased, except for totally rural dependent areas in the Northeast. These nine counties in the Northeast reduced their current spending substantially--$140 per capita. As in most other areas in the Northeast, however, revenue effort for these areas actually declined. In addition, like core metro areas in the Northeast, these areas increased their capital spending at a time when their current spending declined. Hence, once again we do not have evidence of the worst case scenario.

The best example of a combination of rising revenue efforts and declining spending was in independent, totally rural areas in the Northeast. This category, consisting of only five counties, cut current spending $83 per capita, cut capital spending $66 per capita, and increased revenue effort by 0.2 percent of income. This example still does not fit the worst case scenario because it did not result from declining fiscal capacity. Fiscal capacity actually increased for this group of counties. Other explanations must be sought to explain the fiscal trends in these areas; for example, Federal and State aid declined substantially, and spending on education and "other" nonspecified functions was cut substantially in these areas.